USI ADVISORS, INC.

MARKET & LEGAL UPDATE

February 2022 REVIEW

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"Russia's Invasion of Ukraine puts Markets on Edge"

After a rocky start in January as investors were grappling with rising inflation, supply chain issues and a Federal Reserve that is getting ready to move to tighter monetary policy, geopolitical tensions rose as Russia launched a full-scale invasion on Ukraine. In response, the Western Powers imposed sanctions on Russia's economy, financial institutions and elite individuals, bringing more uncertainty around the overall impact of this war on the global economy and the markets. The Dow Jones Industrial Average (DJIA) was down 3.3% in February. The S&P 500 lost 3% and is down 8% year to date while the NASDAQ Composite is down in the double digits at 12.1% year to date. International developed markets also fell in February, losing 1.8% as measured by the MSCI EAFE Index, while emerging markets lost 3%.

After over two years of dealing with the effects of the pandemic, coronavirus infections, hospitalizations and deaths came down rapidly over the course of recent weeks. Daily cases plummeted 90% from 805,000 at their peak in mid-January to fewer than 67,000 daily cases at the end of February, the lowest level since the omicron variant was confirmed in the U.S. However, just as things were improving on the pandemic front, the conflict between Russia and the Ukraine intensified when Russian President Putin, launched a devastating attack on Ukraine on February 24th.

Market Return Indexes	February 2022	YTD 2022
Dow Jones Industrial Average	-3.3%	-6.4%
S&P 500	-3.0%	-8.0%
NASDAQ (price change)	-3.4%	-12.1%
MSCI Eur. Australasia Far East (EAFE)	-1.8%	-6.5%
MSCI Emerging Markets	-3.0%	-4.8%
Bloomberg Barclays High Yield	-1.0%	-3.7%
Bloomberg Barclays Aggregate Bond	-1.1%	-3.3%
Yield Data	**February 2022**	**January 2022**
U.S. 10-Year Treasury Yield	1.83%	1.79%

As of the writing of this commentary, Russian military forces have recognized two regions in eastern Ukraine as independent, Donetsk and Lugansk. Ukraine's armed forces continue to retain control of key cities and are slowing Russia's advance on Ukraine's capital, Kyiv. A round of talks was held between Ukrainian and Russian officials at the Ukraine-Belarus border at the end of February, however, it ended with no resolution. Western countries, while committed to keeping their troops out of direct conflict with Russia's military, have been supporting Ukraine's efforts by sending arms shipments and imposing extensive sanctions aimed to hurt Russia's economy and financial system, essentially reversing 30 years of post-Cold war engagement. Germany halted the approval of the Nord Stream 2 gas pipeline and most countries in Europe have shut off airspace to Russian airlines. The U.S., EU, UK and Canada banned some Russian banks from the SWIFT global payments system, a network which allows for rapid transfer of money across borders. It didn't take long for the effects of these sanctions to put a substantial stress on Russia's financial system as the ruble plunged 30% against the dollar, boosting inflation and making imports more expensive. In addition, the Russian Central Bank doubled interest rates to 20% and ordered the closing of the Moscow Exchange on February 28th. On Sunday, Russia ramped up war efforts as Putin ordered his nuclear forces on high alert in response to what he called NATO "aggression". This type of rhetoric causes uncertainty about the magnitude and direction of this war, triggering shockwaves through the financial markets.

U.S. stocks tumbled at the end of the month and major indexes fell more than 3% during February, their second straight month of losses. Oil surged above $100 a barrel for the first time since 2014. Russia is one of the largest producers of oil and natural gas and a major commodities supplier. Russia is the 5th largest EU trading partner and the lead source of EU gas which raises concerns about energy shortages that could push energy prices higher during a time when inflation is already running at the highest level in four decades. In addition to contributing to existing inflationary pressures and supply chain shortages, investors are weighting how this development may change the direction of the U.S. monetary and fiscal policy. Federal Reserve Chair, Jerome Powell, is set to speak on March 15th regarding the central bank's plans for raising rates. It is anticipated that the Fed will hike rates by a quarter percent, however the pace and magnitude at which they continue to tighten their monetary policy going forward may be impacted by the current situation in Ukraine, inflationary pressures and potential disruption to global growth.

In the latest release, the Federal Reserve's preferred measure of inflation, the Core Personal Consumption Expenditure Index (PCE), which excludes energy and food, was up 5.2% in January, the fastest pace since 1983. The month-to-month increase was 0.5%, same as the last three months. The Consumer Price Index (CPI) rose 0.6% in January and climbed 7.5% over the last 12 months ending in January. Core CPI, which excludes the volatile food and energy components, rose 6% from a year earlier, the largest advance since 1982.

While the human cost of military conflict is immeasurable, and the world anxiously watches this crisis intensify, global stock markets have been resilient to geopolitical events over the long run. In addition, both Russia and Ukraine are relatively small economies and markets, but their impact on supply chains disruptions and commodities could have implications for the global economy. It is also important to note that from a financial markets' exposure, Russia only represents 3.2% of the MSCI Emerging Markets Index and only 30 basis points weight of its global benchmarks. As heightened geopolitical and inflationary uncertainties continue, it might contribute to elevated market volatility. However, investors should remember the importance of staying disciplined during periods of market volatility.

LEGAL UPDATE | Supreme Court Decision on Excessive Fees Offers Important Reminders for Plan Fiduciaries

The news about the recent U.S. Supreme Court case issued on January 24, 2022 in *Hughes v. Northwest University* has garnered the attention of many 401(k) and 403(b) plan sponsors. In particular, plan sponsors are wondering what the case means for their retirement plans and their fiduciary obligations. This ERISA case has received a lot of attention because it involves excessive fee litigation filed against a large university, claiming that the plan fiduciaries who oversee the 403(b) plan with over $3 billion in assets imprudently paid excessive recordkeeping fees and offered imprudent investment options. Despite the amount of attention the case has received, the Supreme Court's decision was actually a very narrow one and the Court made no determination on the merit of the plan participants' claims, remanding the case back to the lower court for further proceedings. However, the *Hughes* decision does serve as a powerful reminder that plan fiduciaries have a duty to monitor and periodically review their plan's investment options as to the reasonableness of the number of options, the breadth of risk provided by the investment menu and the fees charged to participant accounts associated with the options.

The Facts and the Lower Court Decisions. Participants in Northwestern University's 403(b) plan alleged that the plans' fiduciaries breached their duty of prudence by the following acts or omissions:

- Failing to monitor and manage recordkeeping fees resulting in unreasonably high fees being charged against their plan accounts;
- Including in the plan's investment menu mutual funds and annuities in the form of "retail" share classes which carried higher fees than those charged by otherwise identical institutional share classes with the same investments; and
- Offering so many investment options that they should have known the sheer number of options would only confuse participants.

The District Court for the Northern District of Illinois dismissed the participants' lawsuit, relying on the fact that the plan fiduciaries had offered a broad range of investment options, many of which did not carry unreasonably high recordkeeping and investment fees. The lower court's decision to dismiss the case was on the basis that there was a diverse menu of investment options, including low-cost index funds, so the plaintiffs could not allege imprudent investment offerings when they had other prudent ones from which to choose. The lower court concluded that the amount of fees charged to each participant was within their own control; therefore, there was no valid claim against the fiduciaries. The court suggested that by providing many reasonable and prudent investments, there was no need for the plan fiduciaries to cull the unreasonable and imprudent investment options. The United States Circuit Court of Appeals for the Seventh Circuit agreed, and the participants sought review by the Supreme Court.

The Supreme Court's Decision. To put it simply, the Supreme Court ruled that the Northern Illinois District Court's and the Seventh Circuit Court's reasoning was flawed. In her opinion, Justice Sotomayor, writing the decision for a unanimous Court, states that the categorical rule enunciated by the lower courts is inconsistent with the context-specific analysis that ERISA requires. The opinion states that this rule fails to take into account the standard the Supreme Court announced in *Tibble v. Edison Int'l,* 575 U.S. 523, 530 (2015). The *Tibble* decision requires that fiduciaries monitor all plan investments and remove any that are determined to be unreasonable or imprudent.

However, the Supreme Court did not engage in a substantive analysis of the facts in this case. Instead, the Supreme Court vacated the decision of the Seventh Circuit and remanded the case back to it, admonishing the Seventh Circuit to consider the decision in *Tibble* and whether the participants had alleged a plausible claim that the plan fiduciaries violated their ERISA fiduciary duty of prudence in the specific circumstances prevailing at the time of their actions.

What does this all mean for you? First and foremost, there is no final word yet on the merit of the participant claims in the *Hughes* case. This may be an instance where the news articles announcing the Supreme Court decision involving excessive fee litigation in favor of the plaintiffs have created an unnecessary sense of alarm.

However, the case is an important reminder that ERISA's fiduciary duties must not be taken lightly. The duty of prudence demands that plan fiduciaries periodically conduct an independent review of their investment menu and replace poor-performing, costly or otherwise imprudent investment options. We recommend that investment performance reviews take place at regular intervals and that all decisions are well documented. It appears that just having a large menu which includes better performing and reasonably priced investment options alongside the poorer options may not be enough to shield fiduciaries from the costs of litigation, let alone potential liability for fiduciary breaches. Finally, this case can serve as a reminder that all fiduciary decisions should follow a written process and procedure that governs the maintenance of plan investments. All decisions regarding the determination of an investment menu should be memorialized, reflecting the diligence and care taken by plan fiduciaries.

We will follow the *Hughes* case, and if warranted, provide an update on its ultimate outcome. In the interim, if you have any questions regarding your plan's process for determining its investment menu or regarding the menu's options themselves, please contact your USI Consulting Group representative.

How USI Consulting Group Can Help

The USI Consulting Group (USICG) team is happy to assist plan sponsors 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.

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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