Market & Legal Update

APRIL 2024 REVIEW

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MARKET UPDATE | Earnings Season in Full Bloom

Despite an overall beat on earnings growth for S&P 500 companies, the S&P 500 and NASDAQ had their worst month since September 2023 and the Dow suffered its worst monthly decline since September 2022. April was a setback for the markets, after posting their best first quarter to start the year since 2019. First quarter earnings reports kicked off in mid-April and by month-end, about half of the companies within the S&P 500 reported earnings results with more than three quarters of the companies' posting earnings above analyst forecasts and about 60% reporting revenues above forecasts. However, higher interest rates continue to loom over the markets with the likelihood of the Fed cutting rates dimming anytime soon as inflation remains elevated. As a result, longer-term bond yields rose sharply, with the 10-year treasury rising to 4.68% from 4.2%, causing bond prices to fall in value. Additionally, geopolitical pressures in the Mideast, Ukraine, and China weighed on the markets.

Market Return Indwexes	April 2024	YTD 2024	2023
Dow Jones Industrial Average	-4.9%	0.9%	16.2%
S&P 500	-4.1%	6.0%	26.3%
NASDAQ (price change)	-4.4%	4.3%	43.4%
MSCI Eur. Australasia Far East *(EAFE)*	-2.6%	3.1%	18.2%
MSCI Emerging Markets	0.5%	2.8%	9.8%
Bloomberg High Yield	-0.9%	0.5%	13.4%
Bloomberg U.S. Aggregate Bond	-2.5%	-3.3%	5.5%
Yield Data	**April 2024**	**March 2024**	**Feb 2024**
U.S. 10-Year Treasury Yield	4.68%	4.20%	4.25%

Earnings growth for S&P 500 companies at month end stood at 3.5%, slightly ahead of the 3.4% earnings growth forecasted ahead of the quarterly results on March 31. Analysts were expecting the third straight quarter of positive earnings growth. For the year, earnings growth was projected to rise by about 11%. Therefore, it is important for earnings growth to remain strong and ahead of analyst projections to justify the higher valuations for S&P 500 stocks.

Earnings growth was projected to **rise by about 11%**, for the year.

During early April, the employment figures were released for March, with 303,000 new jobs being reported compared to the forecast of 200,000, while unemployment ticked lower to 3.8% from 3.9% the prior month. Unemployment levels held in check below the Fed's long-term target of 4% and the continued job market strength reduced the likelihood of a recession. A consensus Wall Street Journal survey of economists lowered the probability of a recession within the next year to 29% from 39% probability set in January. However, the S&P 500 and NASDAQ lost 1.6% and 2%, respectively on the last trade day of the month after the Labor Department's announced that the employment cost index rose by 1.2% in the first quarter and 4.2% from a year ago. The report suggested that inflation is running hotter than expected and weighed on the markets.

March inflation data as measured by the Consumer Price Index (CPI) and Personal Consumption Expenditures (PCE) Index were released in mid-April and late April, respectively. Core CPI rose 3.8% year over year (0.3% for the month) and headline CPI rose 3.5% (0.4% for the month). Inflation results came in hotter than expected with economists expecting 3.7% and 3.4% respectively (and a monthly gain of 0.3% for each). Shelter and energy costs were the primary culprits for the increase, with energy rising 1.1% while shelter costs were 0.4% higher for the month and 5.7% higher from a year ago. The markets reacted negatively to the CPI report as they have done for the last several months following its release. The PCE rose 2.7% in March compared to a Dow Jones consensus of 2.6%, whereas the PCE excluding energy and food rose 2.8% versus the DJ consensus of 2.7%. Personal spending rose 0.8% whereas personal income only increased 0.5%, with the personal savings rate declining to 3.2%.

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Personal savings fell 0.4% from the prior month and were 2% lower than a year ago. The PCE report, unlike the CPI, did not weigh as heavily on the markets after its announcement. However, longer-term rates advanced during the month as Fed funds futures reduced the probability of a rate cut in June from 55% last month to less than 16%. CME FedWatchTool indicates a 45% chance of the first rate cut in September. According to BNP Paribas, a no cut scenario for 2024 was 31%, up from 20% a month ago and a 22% chance of a possible rate hike of 25bp in 2025.

The IMF updated their global economic outlook for 2024 during the month, raising its global forecast for global growth to 3.2% from 2.9% that was previously forecasted last October. The IMF forecasts the world economy growing at 2.8% a year by 2030, which is 1% lower than the average from 2000 to 2019. The IMF attributed slower global growth to the labor supply aging population and elevated government debt levels which could curb the government's capacity to invest.

Geopolitical concerns have also added an additional risk premium to the markets with rising tensions in the Middle East. At about midnight on April 13th Iran launched a full-scale missile and drone attack on Israel in retaliation for an Israeli strike on an Iranian diplomatic complex in Syria that killed two Iranian generals. Israel responded with an airstrike near a major air base and nuclear site in Iran. The U.S. and allies are diplomatically working to de-escalate tensions and avoid a broader regional war from developing. The Ukraine war by Russia has persisted for over 2 years and Congress passed during the month a $95 billion aid package for the Ukraine, Israel, and Taiwan. China continues to remain a threat to Taiwan and the greater South China Sea region.

Global growth forecast **raised to 3.2%** from 2.9% that was *previously forecasted* last October.

For the next month and beyond, the Fed was meeting April 30 and May 1 and was expected to hold the Fed Funds rates steady at 5.25% to 5.5%. The markets instead would focus on any clues to help determine the trajectory of rates going forward. On May 3, the Labor Department was to report employment figures for April. The remaining quarterly reports for S&P 500 companies would largely be released throughout May. Inflation figures for April would be available for the CPI in mid-May and PCE in late May. While higher rates continue to weigh on the market, it should be noted that had the markets been correct at the beginning of the year with the prediction of as many as six rate cuts for the year, that would likely have been the result of global growth slowing down to justify the series of rate cuts. Longer-term market performance can be boosted by unemployment remaining low, global output remaining above forecasts, and companies largely beating analyst projections. Inflation needs to show signs of cooling to assure the markets that the Fed could begin easing interest rates that could help propel global economic growth higher.

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LEGAL UPDATE

SECURE 2.0 ACT: Penalty-Free Withdrawal Changes

Participants who elect to receive retirement plan distributions prior to attaining age 59½ are generally subject to the 10% early withdrawal penalty in addition to any applicable income tax. The SECURE 2.0 Act significantly added the penalty-free withdrawal options for defined contribution plan participants. These modifications extend the range of situations in which participants can access their retirement funds without paying the 10% early withdrawal penalty, allowing participants more flexibility when facing particular (and often temporary) challenges. **The penalty-free withdrawal changes under the SECURE 2.0 Act discussed below include the following:**

- Withdrawals for **domestic abuse victims**
- Withdrawals for **emergency personal expenses**
- Distributions for **terminal illness**
- **Repayment period** restrictions for penalty-free **Qualified Birth or Adoption Distributions (QBAD)**

Penalty-Free Withdrawals for Domestic Abuse Victims

Beginning in 2024, plan sponsors of 401(k), 403(b) and governmental 457(b) plans can offer penalty-free withdrawals to meet the needs of domestic abuse victims.

ELIGIBILITY. To be eligible for a penalty-free withdrawal under this provision, a participant must fulfill the following requirements:

- *Defining "Domestic Abuse."* The term "domestic abuse" is defined as "physical, psychological, sexual, emotional, or economic abuse, including efforts to control, isolate, humiliate, or intimidate the victim, or to undermine the victim's ability to reason independently, including by means of abuse of the victim's child or another family member living in the household."
- *Timing Requirement.* A distribution shall be treated as an eligible distribution to a survivor if such distribution is taken within **12 months** of the domestic abuse incident from an applicable eligible retirement plan.
- *Proof of Eligibility.* A survivor may **self-certify**. Plan administrators should recommend that survivors retain any relevant "proof" documents in case of an audit, such as court rulings, police records, or other verifications attesting to the person's status as a survivor of domestic abuse.

LIMITATIONS. A survivor may take, in the aggregate, the **lesser of $10,000** (indexed for inflation post-2024) or **50%** of the survivor's vested account balance; the limitation applies to all of the survivor's accounts under all plans in the plan sponsor's controlled group.

REPAYMENT. While the above distribution is not subject to the 10% early withdrawal penalty, it is subject to income tax. However, if the distribution is repaid within three years from the distribution, the tax will be refunded on any amounts paid during that time period. Notably, "domestic abuse victim" distributions can only be repaid to an employer-sponsored plan when the participant is otherwise eligible to contribute to the plan.

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Penalty-Free Withdrawals for Emergency Personal Expenses

Beginning in 2024, plan sponsors of 401(k), 403(b) and governmental 457(b) plans may allow **one** penalty-free withdrawal (per year) for "emergency personal expenses" for the following amount: the **lesser of $1,000** or the participant's **nonforfeitable benefit reduced by $1,000**. By way of example, if the participant's vested account balance is $1,500, the emergency distribution can't exceed $500.

- **ELIGIBILITY.** To be eligible for the "emergency personal expense distribution," the distribution from an applicable eligible retirement plan must be "for purposes of meeting unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses."
- **SELF-CERTIFICATION.** The plan administrator may allow the employee to self-certify in writing that the employee satisfies the conditions of the preceding sentence in determining whether any distribution is an emergency personal expense distribution.
- **REPAYMENT.** The repayment rules for this distribution are similar to the "domestic abuse victim" distribution rules. The income tax on the distribution will be refunded if it is repaid within the **three-year-window** from the distribution. Further, to repay, the participant must be otherwise eligible to contribute to the plan.

No subsequent emergency personal expense distributions will be permitted within a 3 calendar year period unless: *(i)* the previous distribution is fully repaid to the plan; or *(ii)* the aggregate employee contributions to the plan subsequent to the distribution are at least equal to the previous distribution which was not repaid.

Penalty-Free Distributions for Terminal Illness

Plan sponsors can recognize withdrawals as terminally ill distributions for tax purposes.

- **NOT A NEW DISTRIBUTION CATEGORY.** It is important to note that the SECURE 2.0 Act does NOT create a new distribution. It only provides for a new 10% early withdrawal penalty exception. That means the participant must be eligible for the distribution under some other provision that provides a substantive right to obtain the distribution from the plan, like a "medical expense" hardship distribution. The participant can use this exemption whether the plan offers it or not, but the plan must be amended if the administrator wants to address this provision as part of its terms. Unlike some of the other provisions above, participants **cannot self-certify** that they are "terminally ill."
- **ELIGIBILITY.** A doctor must certify that the employee's physical condition or illness is one that is reasonably predicted to cause death within 84 months. The employee is required to provide the plan administrator with "sufficient evidence" of a terminal disease.
- **REPAYMENT.** The three-year repayment provision is consistent with the other options discussed above.

Note: The statute does not put any restrictions on the amount of the distribution nor the number of payments—and some have interpreted the term "employee" as excluding former employees or a plan participant's beneficiaries, although that exclusion is far from clear at this point.

Qualified Birth or Adoption Distributions (QBAD) and the Three Year Repayment Limitation

Pre-SECURE 2.0 Act law exempted participants from paying the 10% early withdrawal tax for qualified birth or adoption distributions **(QBAD)** of up to **$5,000**.

QBADs are still subject to ordinary income taxes even though they are not subject to the 10% early withdrawal penalty. If the distribution is returned to a qualified retirement plan, however, the income taxes paid may be reimbursed.

- **REPAYMENT.** Under previous law, there was no time limit on repayment, but the QBAD provisions were modified by the SECURE 2.0 Act to set a three-year maximum for the recontribution period. With this modification, the QBAD repayment rule now mirrors other Code provisions that prohibit tax refunds from being issued more than three years after a participant's tax return is filed, which means this provision will be easier for plans to administer.

  The three-year limit on repayment is effective for QBADs after December 29, 2022. QBADs made prior to that date must be repaid by December 31, 2025 to be eligible for a refund of income taxes paid.

More SECURE 2.0 Guidance To Come

USI Consulting Group's team is happy to assist employers with all retirement plan compliance matters and changes under the SECURE 2.0 Act. 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. To learn more, please contact your local 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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