MARKET & LEGAL UPDATE

NOVEMBER 2018 REVIEW

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"…And Back Up We Go!"

This isn't the first time we have referenced a roller coaster ride in this Market Update series, and it certainly won't be the last. The roller coaster ride continued for equity markets in November, as stocks were up and down on almost a daily basis during the month. Following a brutal October, which was one of the worst months for the markets since the financial crisis, equities ultimately climbed back with a relatively solid November, as a few timely news items, strong U.S. economic fundamentals, and solid corporate earnings outweighed the trade war and inflation fears that continue to exist.

For much of November, it looked as if the month would end in a similar fashion to October…on a sour note. Late into the month, the Dow Jones Industrial Average (DJIA) was down 830 points as of November 23rd, the day after Thanksgiving. However, in the last 5 trading days of the month, the DJIA roared back, tacking on over 1250 points, which has been credited in large part to three news items. First, news that President Donald Trump and China's President, Xi Jinping, would meet regarding the direction of future trade policy was met with elation. Second, Federal Reserve Chairman Jerome Powell's comments on November 28th signaled a more tempered approach to future rate hikes. Specifically, Powell said that the Fed's benchmark interest rate was "just below" the neutral level, meaning the central bank was close to the point where it would not be tapping the brakes or pressing the gas. This was a much different statement from the previous month, where Powell had said it was "a long way" from neutral, leaving investors worried that faster rate increases would stunt economic growth. Finally, there were no big surprises in the mid-term elections, and markets do not like surprises.

In addition, economic fundamentals continue to look strong in the U.S., with the second estimate of 3rd quarter GDP growth confirming the initial 3.5% estimate. Further, the consumer confidence index data was released on November 27th, coming in at 135.7, which is not far off from the all-time high of 144.7 reached in 2000. Finally, after-tax corporate profits rose a year-on-year 5.9% in the third-quarter to $1.976 trillion without inventory valuation and capital consumption adjustments. As corporate profits continue to impress, markets continue to notice.

The three major domestic indices all finished the month in positive territory. As mentioned above, the Dow Jones Industrial Average roared back at the end of the month and ended up 2.1% for the month, while the S&P 500 Index gained slightly over 2%. Both indices are up over 5% year-to-date. The tech-heavy Nasdaq Composite Index had a bit of a rougher month, gaining only 0.3% as the technology sector was quite volatile. That said, the index is still up 6.2% thus far in 2018. International markets were mixed for the month. Developed international equity markets, as measured by the MSCI EAFE Index, fell a tad, i.e. 0.1%, as Brexit talks and tariff uncertainty applied downward pressure. Year-to-date, the index is down significantly by 9.4%. Emerging markets rebounded, with the MSCI EAFE Emerging Markets Index gaining 4.1% for the month, though the index is still struggling to the tune of a 12.2% loss for the year thus far.

The yield curve continued to flatten in November, with short term yields continuing to rise and intermediate and long-term yields moving down. For instance, while the 3-month, 6-month and 1-year Treasury increased, albeit only marginally, the 3-year, 5-year and so on all fell during the month. Specifically, the 10-year Treasury yield fell from 3.15% at the end of October to 3.01% at the end of November. As a result of intermediate yields declining, the Bloomberg Barclays US Aggregate Bond index gained 0.6% in November, though it is still down 1.7% for the year thus far. In contrast, the Barclays U.S. High Yield Index tumbled 0.9% and is essentially flat for 2018.

	November 2018	YTD
DJIA	2.11%	5.59%
S&P 500	2.04%	5.11%
NASDAQ (price change)	0.34%	6.19%
MSCI EAFE	-0.13%	-9.39%
MSCI Emerging Markets	4.12 %	-12.24%
Bloomberg Barclays	0.60%	-1.69%
Bloomberg Barclays U.S. High Yield	-0.86%	0.06%
	11/30/2018	10/31/2018
U.S. 10-Year Treasury Yield	3.01%	3.15%

At times, markets may be fickle and react quickly and decisively to both good and bad news. Investors may overreact to some events with the perception that this news may be beneficial or detrimental to the economy or markets…or both. While markets may move up or down depending on what President Trump says about tariffs or what Fed Chairman Powell may comment on, purposefully or not, about rates, the underlying fundamentals should be an important factor to consider in a long term investment plan. So, while corporate profits are still strong and our economy is moving in the right direction, the wrong word, wrong tweet, or wrong perception could nullify the underlying fundamentals and send markets downward. Or, as we saw in the last week of November, the perception that things may get better can send markets skyward.

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LEGAL UPDATE | IRS Issues Proposed Regulations Clarifying the New Hardship Distribution Rules

On November 9, 2018, the IRS issued proposed regulations amending the hardship provisions applicable to 401(k) and 403(b) plans. These regulations reflect the statutory changes that were included in the Bipartisan Budget Act of 2018 and the Tax Cuts and Jobs Act with respect to hardship distributions. More importantly, the proposed regulations provide the much-needed clarifications we've been waiting for regarding these new hardship rules.

401(k) Plan Hardship Changes under the Proposed Regulations – the proposed regulations make the following changes to the current hardship rules:

1. Eliminate the requirement that participants suspend their elective deferral contributions for a six-month period after taking a hardship withdrawal.
2. Eliminate the requirement that participants must exhaust any available loans prior to taking a hardship distribution.
3. Allow hardship withdrawals from previously restricted contribution sources, Qualified nonelective contributions (QNECs), qualified matching contributions (QMACs), as well as earnings on QNECs, QMACs, and elective deferrals (making these sources available is optional).
4. Expand the safe harbor hardship conditions that are deemed to meet the immediate and heavy financial need by adding a seventh safe harbor to the list for expenses and losses incurred following a federally declared disaster that occurs in an area designated by the Federal Emergency Management Agency (FEMA).

Additionally, the proposed regulations added a new "general standard" for determining whether a participant has experienced an immediate and heavy financial need to justify a hardship distribution. Instead of making the determination based on all the relevant facts and circumstances, the general standard would apply to determine whether a distribution is necessary to satisfy a financial need. Effective January 1, 2020, the general standard would require plan administrators to:

- Limit the amount of the hardship distribution to the participant's need (including any amounts necessary to pay taxes and penalties on the distribution;
- Verify the participant has taken all available distributions under the plan (other than loans); and
- Obtain a written representation from the participant that he/she has insufficient cash or other liquid assets to satisfy the need (unless the plan administrator has actual knowledge otherwise).

403(b) Plan Hardship Changes under the Proposed Regulations – under the proposed regulations, the same hardship changes as provided above for 401(k) plans will apply to 403(b) plans with two notable exceptions:

1. Earnings on elective deferrals to 403(b) plans will not be permitted for hardship distribution, as the Bipartisan Budget Act of 2018 did not allow for such.
2. QNECs and QMACs held in a 403(b) plan custodial account are not available for hardship distribution.

Effective Dates – the proposed regulations generally go into effect for plan years beginning after December 31, 2018, and plans may begin applying the new rules effective January 1, 2019. However, plans must comply with all rules effective January 1, 2020. The new general standard for determining financial need takes effect January 1, 2020. The proposed regulations also clarify that any six-month deferral suspensions currently in place, can be eliminated as of January 1, 2019, but no such deferral suspensions will be permitted beginning on and after January 1, 2020. The seventh safe harbor condition for FEMA declared disasters can be effective with plan years beginning on or after January 1, 2018.

Plan Amendments – the IRS anticipates finalizing these regulations as proposed, and once they are finalized, plan sponsors will have to amend their plans for these hardship distribution provisions.

Tax Treatment – the tax treatment of hardship distributions remains unchanged. Under current law, hardship distributions are generally taxable and subject to a 10% early withdrawal tax. If you have any questions regarding these hardship rule changes and the proposed regulations, please contact your USI Consulting Group representative.

For previous market commentaries please click here.

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.

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