MARKET & LEGAL UPDATE

JANUARY 2018 REVIEW

USI Advisors, Inc.

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CORPORATE OFFICE:

95 Glastonbury Blvd.
Suite 102
Glastonbury, CT 06033
860.652.3239

USI Consulting Group is an affiliate company of both USI Advisors, Inc. and USI Securities, Inc.

USI CONSULTING GROUP OFFICES:

350 Fifth Avenue
Suite 3700
New York, NY 10118

900 South Gay Street
Knoxville, TN 37902

312 Elm Street 24th Floor
Cincinnati, OH 45202

50 Cabot Street
Needham, MA 02492

2400 East Commercial Blvd
Suite 600
Fort Lauderdale, FL 33308

5200 N. Palm Ave
Fresno, CA 93704

5990 Greenwood Plaza Blvd, Bldg #2, Suite 250, Greenwood Village, CO 80111

2711 N. Haskell Ave
Suite 2000
Dallas, TX 75204

601 Union Street, Suite 1000, Seattle, WA 98101

222 S. Riverside Plaza, Suite 630, Chicago, IL 60606

8049 Corporate Center Drive, Charlotte, NC 28226

USI Advisors, Inc.
www.usiadvisorsinc.com

"The January Effect"

While the Polar vortex was not kind to much of the U.S. in late January, the equity markets added extra fuel to the fire to keep investors warm inside. U.S. equity markets regained their footing, with the Dow posting a 7.3% gain, its highest for January in the last 30 years. This was much needed after enduring the worst Christmas Eve for U.S. equities and worst December since 1931. Last year was one of only 3 years since 1926 where U.S. equities, government and corporate bonds, and commodities all did worse than cash (1931 and 1981). Intermediate-term bonds, as measured by the broad-based Bloomberg Barclays Aggregate Bond index, had a total return of 1.1% during the month, compared to a flat return for all of 2018. The Fed's reversal to a more dovish tone on interest rates to reflect slowing global growth and trade tensions, helped fuel the rally.

Over the last 90 years, the average monthly return for U.S. large caps in January was about 1.4%, compared to slightly under 1% for other months. The January Effect occurs from tax selling of equities from the prior month and particularly, small cap equities tend to trade higher in January as tax motivated selling abates. December's heightened volatility certainly exacerbated tax selling. For January, small cap equities returned 11.3%, outperforming the broader market. In addition, money managers and institutions (pension plans, state, endowments) tend to rebalance their portfolios at year-end to re-align to strategic and target allocations. These two market forces tend to propel stock prices in January due to increased fund flows.

The one positive to last month's turmoil was stocks becoming more reasonably priced to their underlying fundamentals, namely expected future earnings. After December's rout, the price earnings (PE) ratio for U.S. equities in the S&P 500 is slightly below its 10-year average. Forward guidance by S&P 500 companies for 2019 are factoring in slowing growth this year. GDP growth is expected to slow to 2.3% in 2019, from about 3% in 2018 and 2.6% last quarter, with first quarter growth this year projected at 1.8%. Despite declining growth, the economy is on solid ground. Unemployment is near a 50-year low, inflation is near the Fed's target of 2%, and household spending is growing strongly. The U.S. labor market had its 100th straight month of increased employment and wages rose 3% from the prior year.

On January 30, Fed Chairman Jerome Powell sent a more dovish signal with the likelihood of a rate hike by September now less than 10%. The Fed's stance on interest rates acknowledges that global economies are slowing and the trade impasse remains. The International Monetary Fund (IMF) continues to revise World growth projections for 2019 and 2020 downward by 0.2% and 0.1% respectively from last October's projections. China, the world's second largest economy, reported its slowest economic growth since 1990. Germany slashed its economic growth outlook to 1% from 1.8% for this year. Europe grew at 1.5% last year, its slowest pace in five years. According to S&P, slowing global growth and trade contribute to a 15-20% probability of a U.S. recession in 2019.

	January 2019	Last 3 Months	YTD 2019
Dow Jones Industrial Average	7.3%	0.1%	7.3%
S&P 500	8.0%	0.3%	8.0%
NASDAQ (price change)	9.7%	-0.3%	9.7%
MSCI Europe Asia Far East	6.6%	1.3%	6.6%
MSCI Emerging Markets	8.8%	10.2%	8.8%
Bloomberg Barclays High Yield	4.5%	1.4%	4.5%
Bloomberg Barclays Aggregate	1.1%	3.5%	1.1%
	1.31.2019	12.31.2018	
U.S. 10-Year Treasury Yield	2.63%	2.68%	

On tap for February and March are the ongoing trade negotiations with the U.S. and China. Both countries are making progress, but complicated issues critical to the U.S. such as forced intellectual property transfers to Chinese firms and the business dealings by Huawei, China's telecommunications giant, remain at large. President Trump and Xi Jinping of China plan to meet later in February, with the 90-day reprieve set to expire on March 1. Trump also plans to have a second meeting with Kim Jong-un of North Korea later in February. February 15 marks the self-imposed deadline for an agreement on border security to avoid another possible government shutdown. The deadline for Britain to exit (Brexit) the European Union is March 29. In addition, companies are in the middle of earnings season reporting financial results. More than half of the S&P 500 companies have yet to report their latest quarterly results. However, according to FactSet, 71% of those reporting exceeded analyst expectations, which further propelled the January effect. Although the U.S. economy and earnings have been strong, caution remains as declining longer term yields the past three months signal a warning of slowing growth. U.S. equities and bonds rallying together in January is an atypical pattern that could reverse course.

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LEGAL UPDATE | **IRS Announces Electronic Filing System for Plan Corrections and Some User Fee Increases**

Electronic VCP Process Required April 1st: Plan Sponsors can correct certain plan errors and mistakes by using the IRS Employee Plans Compliance Resolution System (EPCRS). In general, under EPCRS there are three ways to correct plan errors: 1) the Self-Correction Program (SCP), which does not require filing a submission with the IRS; **2) the Voluntary Correction Program (VCP), which does require filing a submission with the IRS;** and 3) Audit Closing Program (Audit Cap), which is the process for correcting once the plan is under IRS audit.

The VCP program permits Plan Sponsors to correct plan errors, at any time prior to an IRS audit, related to plan document and significant operational errors. VCP corrections require an application submission and a filing fee payable to the IRS. The IRS recently announced that all VCP applications and the payment of fees must be submitted through an online electronic process only, effective April 1, 2019. Although the online system has been available since January 1st, paper submissions will still be accepted through March 31st, but all applications must be submitted electronically on and after April 1st.

The filing fees for VCP submissions depends on the total amount of plan assets. There's a $1,500 VCP filing fee for plans with total assets of $500,000 or less, a $3,000 VCP filing fee for plans with total assets in excess of $500,000 to $10,000,000, and $3,500 VCP filing fee for plans with total assets in excess of $10,000,000.

IRS User Fee Increases: The IRS recently announced certain user fee increases for some types of requests. Effective February 2, 2019, the user fee to submit a request for a Private Letter Ruling, under the jurisdiction of the Associate General Counsel, will increase from $28,300 to $30,000; however, the user fee to submit a request for a Private Letter Ruling, under the Employee Plans Office, remains at $10,000. Effective July 1, 2019, the user fee to submit an Application for Determination for a Terminating Plan (IRS Form 5310) will be increased from $2,300 to $3,000; however, the user fee to submit an Application for Determination Letter for an individually designed plan (IRS Form 5300) remains at $2,500, and the user fee to submit an Application for Determination for Adopters of Modified Volume Submitter Plans (Form 5307) remains at $800.

If you would like more information on this topic or have any questions, please contact your USI Consulting Group representative.

For previous market 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.

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