MARKET & LEGAL UPDATE

FEBRUARY 2020 REVIEW

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CORPORATE OFFICE:

95 Glastonbury Blvd., Suite 102
Glastonbury, CT 06033
860.652.3239

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"Has the Market Correction Arrived?"

As markets have soared for the past 10 years, many felt that it wasn't a matter of if, but when some sort of market correction would occur. February 2020 appears to be the answer to that question. While there have been viral respiratory syndrome outbreaks in the last 20 years such as MERS (2012) and SARS (2003), the coronavirus outbreak was not known to the world at the beginning of the year and thus not factored into global market expectations. Even after the outbreak was made official on January 20th, markets steadily rose for nearly a month after, confident the virus could be contained. However, with the coronavirus outbreak spreading rapidly outside of China, the impending global economic impact of such an epidemic has caused significant uncertainty in the markets. This uncertainty has led to markets falling at a record setting pace.

On February 19th all three major domestic equity indices, the Dow Jones Industrial Average, the S&P 500 and the Nasdaq, closed at record highs. Fast forward to the end of the month and all three were in correction territory, having dropped more than 10% from those highs. The markets have been reacting to daily updates on the coronavirus since January but the impact on the markets in February was quite substantial. For instance, the S&P moved into correction territory in a mere 6 days, which is the fastest it has ever done so in its history. Further, the Dow experienced a loss of almost 1200 points on February 27th, the largest one-day point drop ever recorded, however the 4.4% decline does not rank in the top 20 for worst single day percentage declines for the Dow.

Market Return Indexes	February 2020	YTD 2020
Dow Jones Industrial Average	-9.8%	-10.6%
S&P 500	-8.2%	-8.3%
NASDAQ (price change)	-6.4%	-4.5%
MSCI Eur. Australasia Far East (EAFE)	-9.0%	-10.9%
MSCI Emerging Markets	-5.3%	-9.7%
Bloomberg Barclays High Yield	-1.4 %	-1.4%
Bloomberg Barclays Aggregate Bond	1.8%	3.8%
Yield Data	**Feb 29 2020**	**Jan 31 2020**
U.S. 10-Year Treasury Yield	1.13%	1.51%

As indicated last month, history has shown that panic about previous epidemics has subsided once the number of cases starts tapering off. With that in mind, on the positive side of the equation, coronavirus cases inside China have begun to slow down and the mortality rates tend to be skewed towards the older population with pre-existing conditions. However, on the negative side of the equation, cases outside of China are on the rise, especially in South Korea, Italy, Iran and Japan, and that lack of containment is concerning. Since global markets are much more integrated than 17 years ago and China's economy, now the second largest in the world, has GDP of $14.1 trillion vs $1.7 trillion in 2003, China today is much more vital to supply chains of the world and impacts about 20% of the world's GDP. More specifically, the concern is that the outbreak will affect the global economy more than originally anticipated, and this seems to be the main issue driving markets lower.

As a way to contain the virus, Chinese business travel is at a standstill, many factories in China remain closed, and consumer spending has suffered as a result of quarantines and stores being closed. As such, the economic impact to China is expected to lower the nation's GDP from 6.0% to 5.6% according to the International Monetary Fund and PIMCO. This is after China's economy already contracted to 6.0% last year, its lowest since 1990. Further, while there are reports of some Chinese factories reopening, most activity indicators are still close to their post-lunar new year lows. The factory closures have disrupted global supply chains, impacting companies across the globe. Tech giant Apple is expected to miss revenue projections for the quarter due to the epidemic and temporarily closed production in China but has since re-opened operations at the end of February. Moreover, as the virus has spread to every continent except Antarctica, other business travel outside of China has also started to be curtailed, as companies try to avoid putting their employees at risk of contracting the virus. As such, markets are now pricing in large earnings declines from this health crisis in 2020. For example, Goldman Sachs has most recently forecasted zero earnings growth for 2020, when markets had priced steadily rising earnings growth to the mid-teens by year-end before the outbreak was announced.

As for the U.S., it is inevitable that exports of goods and services to China will decrease. And while the U.S. is certainly reliant on Chinese supply chains, it's much more reliant in certain industries than others. Per JP Morgan, electronics, furniture, machinery and apparel are all impacted, but none of these reliance shares exceed 20%. Moreover, manufacturing and wholesale inventories are currently at high levels, which could help minimize the impact of the supply chain disruptions. As such, the estimated economic impact of the virus on the U.S. may be less than expected. In addition, the Fed will be under pressure to reduce interest rates to support growth, and Fed Fund futures point to a 100% probability the Fed will cut rates at the next meeting. The expectation is that the Fed Funds rate will be near 1% by year end, representing two rate cuts.

As we have discussed in the past, markets abhor uncertainty. Unfortunately, there is not much certainty pertaining to the coronavirus at this time. Specifically, the rate at which the virus may spread, the way in which it spreads, the cure, among other things are all unknown and are clearly important items to consider. However, markets are more worried about the economic impact of the virus and that is the biggest unknown at this point. Financial markets will continue to be at risk until the number of new cases outside of China reaches a peak, which is impossible to determine at this time. While markets and investors alike may continue to experience volatility, it is important to remember that timing the market rarely works and over its history, the Dow has gone up despite year-over-year declines for some periods. Staying the course, while difficult in some circumstances, tends to pay off over time.

LEGAL UPDATES

1. SECURE Act: Participation and Eligibility Requirements for Long-Term Part-Time Employees

The Setting Every Community up for Retirement Enhancement Act (SECURE Act) is the first significant retirement act since the enactment of the Pension Protection Act of 2006 (PPA) and is intended to encourage retirement savings. The SECURE Act changes are substantial and technical. Therefore, certain SECURE Act topics will be highlighted in greater detail throughout the year, especially as specific guidance is issued from the IRS and Department of Labor regarding certain provisions.

This month we are highlighting the new participation requirement rules under the SECURE Act for certain long-term part-time employees.

401(k) plans *must* allow certain long-term part-time employees working at least 500 hours to participate in the plan.

The SECURE Act expands eligibility requirements to require 401(k) plans to permit certain long-term part-time ("LTPT") employees to contribute salary deferrals to the plan. Under the new law, effective January 1, 2021, LTPT employees are employees who: (i) have attained age 21; and (2) have worked 3 consecutive 12-month periods in which they have performed at least 500 hours of service, but less than 1,000 hours. Plan years prior to January 1, 2021 can be disregarded for purposes of determining a LTPT employee's eligibility, which means the earliest date a LTPT employee could become eligible to participate in the plan is January 1, 2024.

Once a LTPT employee becomes eligible to participate, he or she must be allowed to make employee elective deferrals into the plan. However, plans are not required to make any employer contributions for LTPT employees. The SECURE Act also does not require plans to include LTPT employees in their annual nondiscrimination testing nor does the SECURE Act require plans to make any top-heavy minimum contributions for LTPT employees.

Note: 403(b) plans, 457(b) plans, and collectively bargained plans are not subject to the above requirements.

Next Steps

The special eligibility rules for LTPT employee participation are complex and the full impact of these changes to 401(k) plans is still unknown. We expect more guidance from the IRS on these participation rules in the near future. In the meantime, plan sponsors of 401(k) plans should begin to review and/or implement record-keeping systems for their part-time employees in order to start tracking the hours of service for these individuals for plan years beginning after December 31, 2020.

2. Reminder: Important Restatement Deadlines Approaching

403(b) plans

The deadline for the initial remedial amendment period for 403(b) plans is March 31, 2020, and plan sponsors have until such date to restate and sign their plan documents to ensure their plans are in compliance with the Internal Revenue Code Section 403(b).

Defined Benefit plans

The remedial amendment period deadline for pre-approved defined benefit plans is April 30, 2020, and plan sponsors of pre-approved defined benefit plans have until such date to restate and sign their plan documents.

If you have any questions or would like more information on these topics, 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.