MARKET & LEGAL UPDATE

FEBRUARY 2021 REVIEW

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CORPORATE OFFICE:

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

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"Bond Yields Surge Amid Signs of Economic Recovery"

U.S. equity markets finished higher in February, erasing their losses from the prior month, as positive developments on the coronavirus front, improving economic data, strong corporate earnings, and prospects of another fiscal stimulus package continued to boost investor sentiment. The S&P 500 rose 2.8% last month, whereas the Dow Jones Industrial Average edged up 3.4% amid a steady decline in U.S. Covid-19 cases and hospitalizations. Smaller companies, as measured by the Russell 2000 Index and more closely tied to the health of the U.S. economy, outperformed their large-cap peers, returning 6.2% during the month and were up 11.6% year-to-date. By contrast, the tech-heavy Nasdaq Composite, which had posted some of the strongest returns since last March, started to lose momentum towards the end of the month amid rich valuations and increasing bond yields.

U.S. government bond yields rose swiftly during the month, fueled by positive news on the vaccine front and a powerful economic recovery. Rising longer-term yields, such as the U.S. 10-Year Treasury, caught markets by surprise, triggering a market selloff during the last two weeks of the month. On February 25th, U.S. stocks fell sharply as the U.S. 10-year Treasury yield continued to surge above the 1.5% mark, reaching its highest level since February 2020 and registering its largest one-day advance since November. Yields, which rise when bond prices fall, reflect market expectations of a robust economic growth and potential for increasing inflation. Despite inflation fears, the Federal Reserve Chairman Jerome Powell reiterated that the central bank would continue to support the economy with low interest rates and hefty bond purchases. Federal Reserve officials have indicated that the climb in long-term bond yields is healthy, reflecting a better outlook for the U.S. economy.

Market Return Indexes	February 2021	YTD 2021
Dow Jones Industrial Average	3.4%	1.4%
S&P 500	2.8%	1.7%
NASDAQ (price change)	0.9%	2.4%
MSCI Eur. Australasia Far East (EAFE)	2.2%	1.2%
MSCI Emerging Markets	0.8%	3.9%
Bloomberg Barclays High Yield	0.4%	0.7%
Bloomberg Barclays Aggregate	-1.4%	-2.2%
Yield Data	**February 2021**	**Januaryy 2020**
U.S. 10-Year Treasury Yield	1.44%	1.11%

Rising yields can weigh on stocks in a few different ways. Higher interest rates would result in higher borrowing costs for companies, hindering profits. In a rising interest environment, some income-seeking investors also may rethink their asset allocation, moving out of equities and returning to government and corporate fixed income securities. From a valuation standpoint, when yields move higher, the expected cash flows for businesses become less valuable, notably putting more pressure on companies with higher expected earnings growth, such as technology stocks. Consequently, investors continued to rotate out of technology stocks during February, moving into more economically sensitive sectors, such as energy and banking that would benefit from the anticipated rebound.

The economy is showing signs of continued recovery in the new year, propelled by a solid increase in income and strong consumer spending. According to the U.S. Department of Commerce, personal income, which is the amount received from wages, investments, and government programs, increased 10% in January from the previous month. The jump was the second biggest on record, largely bolstered by the $900 billion Covid-19 relief bill in late December. There will be an additional fiscal stimulus pouring money into the economy soon, as the U.S. Democratic-led House passed a $1.9 trillion Covid-19 aid package over the weekend, which incorporates $1,400 direct payments to many Americans, enhanced federal unemployment benefits, funding for coronavirus vaccine distribution, and aid for state and local governments, among other measures. The legislation will go to the Senate next, where it is expected to be approved with some potential changes, mainly related to the federal minimum wage hike (from $7.25 to $15 hourly rate).

Consumer spending surged 2.4% in January, fueled by stimulus checks and enhanced federal unemployment assistance, which was the first gain in three months. Spending declined at the end of 2020 due to business restrictions imposed across much of the country to suppress the spread of virus infections, limiting consumers' ability to spend. As new cases of Covid-19 have been declining this year, some states have eased restrictions, boosting spending on goods, notably long-lasting big-ticket items as well as services. Meanwhile, the U.S. job market continues to stabilize after struggling earlier in the winter due to the pandemic-induced restrictions. The number of workers filing for unemployment benefits declined by 111,000 to a seasonally adjusted 730,000 in the week ended February 20th, the lowest weekly level since late November and the largest weekly drop since August. Furthermore, according to the U.S. Bureau of Labor Statistics, the unemployment rate fell sharply by 0.4% to 6.3% in January. The largest drop in unemployment resulted from some people finding jobs, whereas other workers dropped out of the labor force and were no longer counted as unemployed. Although the pandemic-challenged labor market has struggled to recover this winter, it should continue to trend in the right direction over the second half of this year considering accelerating vaccine rollouts.

There was an encouraging step taken in the fight against the coronavirus as the Food and Drug Administration authorized Johnson & Johnson's single shot Covid-19 vaccine for emergency use at the end of February. Despite having an efficacy of 72% at preventing Covid-19 disease in the U.S. as compared to Moderna's and Pfizer's vaccines of roughly 95% efficacy rate, health authorities are urging people to get whichever vaccine becomes available to them first, emphasizing the safety and effectiveness of each shot. The rollout of the J&J vaccine is expected to boost the U.S. supply of vaccines, delivering a total of 100 million doses domestically by the end of June. Pfizer-BioNTech and Moderna have also pledged to provide 600 million doses from their two-shot vaccines by the end of July, which should provide sufficient vaccines to meet demand and cover any American who wants to get vaccinated.

2021 has started out on a positive note for equity markets as investors have grown increasingly confident about the prospects of a strong economic rebound, improving corporate profits, accommodative monetary policy, and an additional fiscal stimulus. The spike in long-term bond yields should not be considered as a structural threat to the anticipated recovery. The economic activity is poised for a growth boom this year as Covid-19 cases fall, vaccine rollouts spread and lockdowns end. However, any adverse developments related to the coronavirus that slow down the economic reopening could potentially trigger more volatility ahead. Keeping a long-term perspective and maintaining a balanced approach can help avoid making irrational decisions in times of volatility.

LEGAL UPDATE | SECURE Act: Long-Term Part-Time Employees

The Setting Every Community up for Retirement Enhancement Act (SECURE Act) includes new 401(k) eligibility and vesting requirements for certain long-term part-time employees. In connection with these requirements, the Internal Revenue Service (IRS) released Notice 2020-68, which provides further clarification regarding the rules for long-term part-time employees.

What are the Long-Term Part-Time Employee Requirements?

The SECURE Act expands the eligibility provisions of 401(k) plans to require that long-term part-time ("LTPT") employees, who previously could have been excluded from participating in the plan if they failed to complete 1,000 hours of service, must now be permitted to make salary deferral contributions into the plan if certain criteria are met. While the SECURE Act excludes contributions made by LTPT employees from nondiscrimination testing and does ***not*** require plan sponsors to make employer contributions to LTPT employees, special vesting requirements apply in the event the employer decides to make such contributions.

Special Eligibility Rules

Under the SECURE Act, effective January 1, 2021, eligible LTPT employees are defined as employees who: (1) have attained age 21; and (2) have worked each of 3 consecutive 12-month periods during which they have performed at least 500 hours of service, but less than 1,000 hours of service. Plan years prior to January 1, 2021 can be disregarded for purposes of determining whether a LTPT employee must be permitted to make elective deferral contributions, which means the earliest date a LTPT employee could be required to become eligible to participate in the plan is January 1, 2024. After LTPT employees meet these criteria, they will be eligible to contribute salary deferrals to the 401(k) plan during any future year.

The "special eligibility rules" only apply to employers who sponsor 401(k) plans, meaning the new eligibility rules do not apply to LTPT employees of employers who sponsor 403(b) plans or 457(b) plans. In addition, the "special eligibility rules" do not apply to collectively bargained plans.

Employer Contributions and Special Vesting Rules

The SECURE Act does not require the employer to provide employer contributions to LTPT employees who become eligible to defer. However, if the plan does provide employer contributions to LTPT employees, then all years of service with the employer during which the LTPT employee had attained age 18 and was credited with at least 500 hours of service during a 12-month period must be credited for vesting purposes to determine the LTPT employee's nonforfeitable right to such employer contributions.

Testing Requirements

The SECURE Act 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 on behalf of LTPT employees.

What are the Next Steps for Employers to Implement Long-Term Part-Time Employee Requirements?

Tracking Hours for Part-Time Employees

401(k) plan sponsors who do not already track hours, should implement a system of record-keeping to track hours of service performed by their part-time employees for plan years beginning after December 31, 2020 in order to determine their eligibility to defer into the plan. For plans that do not want to track hours for eligibility purposes, they may consider other alternatives such as allowing part-time employees to enter and make employee deferrals only or allow all part-time employees to enter the plan as of January 1, 2024. However, careful consideration should be given to alternative approaches, as the exemptions from the testing requirements only apply to employees who are actually classified as LTPT employees.

We continue to monitor the SECURE Act requirements, and we will provide additional updates as new information becomes available. If you have any questions or would like additional information, 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.

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.