# MARKET & LEGAL UPDATE
## December 2021 REVIEW



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CORPORATE OFFICE:

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

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### *"Stocks Capped off Another Banner Year Amid Covid-19 and Rising Inflation"*

**Robust economic data and rising consumer confidence helped elevate equity markets to near record highs to close the year. Despite the ongoing uncertainly caused by the Omicron variant and continued inflationary pressures driven by disrupted global supply chains, all three major indexes posted double-digit returns in 2021, the third consecutive year of strong gains. The S&P 500 advanced 28.7% for the year, registering 70 record-high closes, whereas the Dow Jones Industrial Average and NASDAQ Composite have advanced 21.0% and 21.4%, respectfully, with all three notching their best three-year performance since 1999. International developed markets continued to lag U.S. equities amid the reimposition of tight coronavirus restrictions in a handful of European countries ahead of the holidays, as the MSCI EAFE Index gained 11.3% for the year. Meanwhile, Treasury yields ticked up notably higher in December, with the benchmark 10-year U.S. Treasury note jumping to 1.52% from 1.44% at the end of November amid growing concerns over sustained inflation.**

The highly contagious Omicron variant has spread rapidly in the U.S., outpacing this summer's Delta variant in the level of daily case infections, although some reports indicated that the latest variant could be less severe and lead to fewer hospitalizations. According to Johns Hopkins University, new daily Covid-19 infections in the U.S. reached a record-breaking rate of 512,553 cases on December 28th, far surpassing the highest record of 294,015 cases that was set on January 12th, when the nation was coming off a peak of infections last winter. Omicron, which was first detected in southern Africa in November, became the most dominant strain of coronavirus in the U.S. within weeks. The latest variant accounted for 59% of all U.S. new Covid-19 cases as of December 25th, according to the U.S. Center for Disease Control and Prevention (CDC), whereas 41% of cases were caused by the Delta variant during the same period.

| Market Return Indexes | Decemberr 2021 | YTD 2021 |
|---|---|---|
| Dow Jones Industrial Average | 5.5% | 21.0% |
| S&P 500 | 4.5% | 28.7% |
| NASDAQ (price change) | 0.7% | 21.4% |
| MSCI Eur. Australasia Far East (EAFE) | 5.1% | 11.3% |
| MSCI Emerging Markets | 1.9% | -2.5% |
| Bloomberg Barclays High Yield | 1.9% | 5.3% |
| Bloomberg Barclays Aggregate Bond | -0.3% | -1.5% |
| **Yield Data** | **Dec. 2021** | **Nov. 2021** |
| U.S. 10-Year Treasury Yield | 1.52% | 1.44% |

The Omicron outbreak combined with winter storms led to widespread travel disruptions during the holiday travel season, with more than 2,000 domestic flight cancellations over the Christmas holiday weekend. While the number of air travelers has nearly doubled from last year, the nationwide spike in Omicron cases has caused staff shortages, as more pilots and flight attendants called in sick, resulting in subsequent delays and cancellations. Meanwhile, based on growing evidence that the latest virus has a shorter incubation period, the CDC cut the isolation period in half, to five days, for people who have been infected with Covid-19 and are asymptomatic, followed by five additional days of wearing a mask around other people. The new guidelines for shorter isolation times can help some industries that had experienced staff shortages, as the Omicron variant has sickened many of their workers. Despite the looming surge of Covid-19 cases, U.S. consumers exhibited strong optimism during the holiday season. According to the Conference Board, the Consumer Confidence Index, a measurement of Americans' view of current and future economic conditions, jumped to 115.8 in December from 111.9 (an upward revision) in the prior month, which was its highest level since July. Notably, consumers' concerns about inflation declined early last month after reaching a 13-year high in November, while worries about Covid-19 abated slightly at the same time. However, the survey may not be fully indicative of the recent surge in cases driven by the Omicron variant and rising prices since the consumer confidence reading was released nearly a week earlier than usual due to the holidays.

Meanwhile, U.S. retail sales had a modest gain of 0.3% month-over-month in November, the smallest advance in four months and well below market expectations of 0.8%. The softer-than-expected report suggested that many Americans, who worried about potential shipping delays and out-of-stock items, shopped earlier than in years past. The sales increase in October showed the biggest gain in seven months, mostly led by strong online shopping. Furthermore, recent holiday shopping data indicated that the consumers continued to propel the U.S. economy forward thanks to strong balance sheets and high saving rates. According to Mastercard Spending Pulse, which follows aggregated sales activities in the Mastercard payments network and surveyed-based estimates for cash and checks, retail sales increased 8.5% between November 1st and Christmas Eve compared with the same period in 2020, the strongest growth in seventeen years, although slightly below expectations of 8.8% growth. Most notably, sales at brick-and-mortar stores rose 8.1% compared with last year and 2.4% compared with 2019, as American consumers rushed to physical stores amid supply-chain slowdowns.

The labor market has seen a strong recovery over the course of 2021 as the unemployment rate dropped from 6.7% in December 2020 to 4.2% by November 2021, the lowest level since the start of the pandemic. Furthermore, initial jobless claims, a proxy for layoffs, remained around the lowest levels in more than half a century in December amid a lack of labor supply. According to the Labor Department, in the week ending December 25th, first-time claims for unemployment benefits fell to a seasonally adjusted 198,000, whereas the four-week moving average, which removes weekly volatility, dropped to the lowest level since October 1969. At the same time, November nonfarm payrolls increased by merely 210,000, well below market expectations for a 550,000 gain, as companies continued to struggle to hire and retain workers amid a robust economic momentum. Notably, nonfarm employment remains 3.9 million below its level in February 2020, whereas the workforce has 2.4 million fewer workers than prior to the pandemic. The labor force participation rate has declined from pre-pandemic participation rate of 63.3% to 61.8% in November mainly due to the aging of the Baby Boomer generation and lower level of immigration.

The labor supply shortage has been accompanied by strongly rising wages as businesses compete to hire and retain employees. Wages for all private-sector workers rose 4.6% year-over-year in the third quarter, with the strongest gains reported in the retail and hospitality sectors. However, the real value of wage growth has been erased by rising prices as the U.S. annual inflation reached 6.8% in November, its highest level in 39 years and the sixth consecutive month in which inflation climbed above 5%. The sharp hike in consumer prices implies that a booming economy has led to imbalances in supply and demand. In contrast to prior recoveries, the inflation surge has been driven by robust demand for goods such as autos, appliances, and furniture, whereas prices for services have increased at a slower pace due to a softer demand.

High inflation helped prompt the Federal Reserve's latest moves related to interest rates and a reduction in its balance sheet as the economy nears full employment. On December 15th during their two-day policy meeting, as expected, Fed officials announced their plan to wind down pandemic stimulus efforts at a faster rate, ending the purchases of Treasuries and mortgage-back securities (MBS) by March instead of June and increasing the fed fund rates potentially three times next year, another three in 2023, and two more in 2024. The Fed maintained that the rollback of its bond-buying program is separate from the upcoming tightening cycle. In the latest economic projections, Fed officials updated their expectations for 4.0% GDP growth, 2.6% inflation, and 3.5% unemployment next year. The Fed's hawkish tone was initially welcomed by markets, which were expecting the faster taper and rate hikes in 2022 and stocks rallied following the Fed announcement. However, U.S. equities reversed their gains the following day, suggesting that investors worried about equity valuations as liquidity would be gradually withdrawn. The gradual removal of excess liquidity and upcoming rate-hike cycle might be accompanied by elevated market volatility in the months ahead.

As investors shift their focus to 2022, Covid-19 will continue to pose uncertainties. The overall economic outlook remains positive, fueled by solid consumer and corporate balance sheets. However, with monetary policy tightening and global economic growth set to slow next year, market returns could moderate after three years of stellar gains and volatility is likely to be more elevated in 2022. Therefore, investors should keep more realistic expectations for market returns and build diversified portfolios based on their own risk tolerance and time horizon.

## LEGAL UPDATE | 2022 Retirement Plan Compliance Update

**Kick-off the new year by marking your calendars with important compliance requirements. To set your organization up for success, we have recapped the key 2022 action items and deadlines below.**

## Required Plan Amendments & Plan Restatements

In 2022, most Defined Contribution ("DC") plan sponsors will need to adopt certain required plan amendments and restate their plan documents to reflect applicable law changes. Below is a summary of the relevant adoption deadlines and required updates. Fees for preparing such plan amendments and plan restatements may be charged against plan assets as administrative expenses, and the failure to adopt plan amendments and restatements on a timely basis may result in significant penalties and adverse tax consequences.

| ACTION ITEM | ADOPTION DEADLINE |
|---|---|
| Cycle 3 Plan Restatement | July 31, 2022 |
| SECURE Act Amendment & CARES Act Amendment | Last day of first plan year beginning on or after January 1, 2022 |

### Cycle 3 Plan Restatement

Under the so-called "Cycle 3 Remedial Amendment Period" all 401(k) Plans, Profit Sharing Plans, Money Purchase Pension Plans and Employee Stock Ownership Plans ("ESOPs") that make use of IRS pre-approved plan documents, must be updated and restated in full, no later than July 31, 2022, to reflect all applicable law changes and discretionary amendments that were made since the end of the last six years remedial amendment period. For a detailed discussion of the Cycle 3 Plan Restatement requirements, please see our October 2020 Benefits in Focus Plan Sponsor Newsletter.

### SECURE Act Amendment

Retirement plan sponsors generally have until the last day of the 2022 plan year to adopt amendments that reflect the SECURE Act's required or optional provisions. For calendar year plans that is December 31, 2022. Under the "Setting Every Community Up for Retirement Enhancement Act of 2019" ("SECURE Act"), the following mandatory and optional changes were made to the rules governing DC plans:

- **Inclusion of Part-Time Workers:** Beginning in 2024, sponsors of 401(k) plans must generally permit long term service part-time employees who are at least age 21, and who have completed between 500 and 1000 hours of service during three consecutive years the opportunity to make elective deferrals under their respective plans.
- **Required Minimum Distributions ("RMDs"):** Beginning in 2020, the age for determining if a participant must begin receiving RMDs was raised from age 70-1/2 to age 72. In addition, on a discretionary basis, plan sponsors may continue to allow actively employed participants who are over age 72 to continue to defer the commencement of RMDs until the year that they retire and surviving spouses of participants may delay commencing RMDs until the participant would have attained age 72.
- **Lifetime Income Disclosures:** Beginning in 2022, most DC plan sponsors must provide an annual notice to plan participants, which provides an estimate of what their monthly retirement income would be based on their current retirement plan savings. Please see detailed discussion below.
- **Birth & Adoption Distributions:** Beginning January 1, 2020, on a discretionary basis DC plan sponsors can permit plan participants to elect to receive penalty-free distributions of up to $5,000 of their vested account balances in the case of the birth or adoption of a child, and to repay such amount later to potentially avoid income taxes.

### CARES Act Amendment

In 2020, under the "Coronavirus Aid, Relief, and Economic Security Act" ("CARES Act"), DC plan sponsors were permitted to adopt the following plan changes on a discretionary basis. If plan sponsors elected to implement these provisions, plan amendments are required by the end of the plan year beginning on or after January 1, 2022 (December 31, 2022 for calendar year plans).

- **Covid-Related Distributions:** "Qualified Individuals" could be permitted to receive Covid-Related Distributions ("CRDs") of up to $100,000 between January 1st and December 31st, 2020. CRDs were subject to income tax, but not the 10% early withdrawal penalty and 20% mandatory income tax withholding. In addition, at the election of the person receiving such distribution, the distribution could be ratably included in taxable income over a three-year period and such taxes could be avoided completely if the distribution is repaid to the Plan or to an IRA within three years.

- **Plan Loans:** Between March 27, 2020 and September 22, 2020, the maximum limit for DC plan loans made to participants who were "qualified individuals" could be increased to the lesser of $100,000 or 100% of the participant's vested account balance under the plan. In addition, loan repayments due from March 27, 2020 to December 31, 2020 could be deferred for up to one year and the principal and interest on a plan loan could be ratably re-amortized for a period of up to one year after the original final payment due date.
- **Required Minimum Distributions ("RMDs"):** DC plans need not be required to make RMDs in 2020 and such distributions, if made, could be rolled over to an IRA or to another qualified plan by the person receiving such distribution.

## Other Items of Interest

### Lifetime Income Disclosures

As noted above, beginning in 2022 DC plan sponsors are generally required to provide plan participants with detailed Lifetime Income Disclosure illustrations at least once every 12 months. Such disclosures are intended to give participants a realistic idea of what their monthly retirement income could be based on their retirement savings and/or current rate of savings. For participant-directed plans, the first annual disclosure must generally be provided no later than with the second 2022 quarterly benefit statement, while for non-participant-directed plans, the first annual disclosure must be provided as part of each participant's annual benefit statement for 2021. A more detailed discussion can be found here.

### 2022 Retirement Plan Compliance Calendars

Plan sponsors can access further guidance on the regular administrative compliance deadlines with our calendars:

- Defined Benefit Pension Plan requirements can be found here
- Defined Contribution Plan requirements can be found here

### 2022 Cost of Living Adjustments

The IRS publishes Cost-of-Living Adjustments ("COLA") applicable to Defined Benefit and Defined Contribution Plans on an annual basis. The 2022 adjustments can be accessed here.

The USI Consulting Group (USICG) team is happy to assist plan sponsors with all retirement plan compliance matters, including those discussed here, to help you mitigate risk and financial impact to your organization. To learn more, please contact your local USICG representative, email information@usicg.com or visit www.usicg.com.

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.*

*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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