Market & Legal Update

NOVEMBER 2023 REVIEW

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MARKET UPDATE | Markets Rally Following Interest Rate Optimism

U.S. stocks experienced their best month in more than a year as inflation measures continue to cool with the increased probability that the Fed interest rate hiking cycle could be coming to an end. The Fed held rates steady in their November meeting, which was followed by another cooling inflation reading, while economic output exceeded expectations. Markets had an overwhelmingly positive reaction to the economic news, with the Dow Jones Industrial Average soaring 9.2%, the S&P 500 gaining 9.1%, and the tech-heavy NASDAQ jumping 10.7% in November. Foreign stocks also rose during the month as the MSCI EAFE Index gained 9.3% and the MSCI Emerging Market Index returned 8.0%.

Market Return Indexes	Nov 2023	YTD 2023
Dow Jones Industrial Average	9.2%	10.7%
S&P 500	9.1%	20.8%
NASDAQ (price change)	10.7%	35.9%
MSCI Eur. Australasia Far East (EAFE)	9.3%	12.3%
MSCI Emerging Markets	8.0%	5.7%
Bloomberg High Yield	4.5%	9.4%
Bloomberg U.S. Aggregate Bond	4.5%	1.6%
Yield Data	**Nov 2023**	**Oct 2023**
U.S. 10-Year Treasury Yield	4.37%	4.90%

November kicked off with the Commerce Department announcing that unemployment ticked up to 3.9%, but due to more people participating in the job market overall, 150,000 jobs were added. Next was the FOMC meeting, during which the Fed announced that they would hold rates steady in the 5.25%-5.50% target range for the second consecutive meeting. While the Committee acknowledged the "strong pace" of economic activity for the quarter and that inflation remains elevated, they also noted that job gains have moderated, housing sector activity has flattened due to higher mortgage rates, and higher interest rates are also weighing on business fixed investment. Furthermore, the Fed stated that they are considering the economic impacts of the cumulative tightening of monetary policy, as well as the lags with which monetary policy affects business activity and inflation. Consistent with prior meetings, Fed Chair Jerome Powell commented that the Committee has not made any decisions for the upcoming meeting in December and made sure to leave their options open, noting that they are constantly assessing incoming economic data on a meeting-by-meeting basis. He also clarified that they are not considering or even discussing rate cuts at this time. Powell made sure to caution that there is still a "long way to go" on taming inflation. Despite Mr. Powell's warning, markets reacted positively to the meeting, as investors began to increase their speculation that the Fed may no longer need to increase rates going forward.

Incoming data throughout the month continued to support the case for holding interest rates steady, as the October inflation report revealed headline inflation (CPI) increased 3.2% on an annual basis, a decline from 3.7% in September. However, the index for shelter continued to rise in October, offsetting a decline in gasoline and resulting in no change over the month after adjusting for seasonality. Core inflation, which excludes volatile food and energy prices, rose 4.0% over the last 12 months, down from 4.1% in September--its smallest 12-month change since September 2021. The Personal Consumption Expenditures (PCE) is the Fed's preferred measure of inflation over CPI. This measure of inflation is considered by many to be more stable, as it accounts for a broader range of source data, revises weights of expenditures following consumer trends, and includes a more comprehensive coverage of goods and services. In any case, inflation appears to be slowing. Indeed, the PCE price index for October increased 3.0% on an annual basis, down from 3.4% in September. Excluding food and energy, the Core PCE price index increased 3.5% from one year ago, down from 3.7% in September, and the lowest level since April 2021, but still well above the Fed's 2% target.

While strong consumer spending during the summer helped fuel GDP to grow to an expected 5.2% on an annual basis during Q3, October data revealed a moderation of this trend, as consumer spending only rose 0.2% for the month, down from 0.7% in September. The slowdown in consumer spending reflects the impacts of higher borrowing costs, elevated credit card debt, dwindling savings, higher rates on mortgages and auto loans, and the resumption of student loan payments, all of which reduce the ability of consumers to spend as they did in the summer months. Nevertheless, consumers spent approximately $38 billion during the five days from Thanksgiving through Cyber Monday according to Adobe Analytics, which reflects a 7.8% increase from the previous year and shows greater consumer appetite to spend despite the negative headwinds. Regardless of higher interest rates, consumers continue to lean on debt for purchases, with household debt reaching $17.29 trillion as of Q3 2023, which includes $1.08 trillion in outstanding credit card balances.

Although the market rebound was welcomed during November, this also opens the door to increased disappointment if the Fed feels that they still need to raise interest rates at any point in the future to continue their fight against inflation. The consumer is showing signs of weakening as the weight of tighter credit conditions and depleted savings has forced a rise in household debt. While economists expect economic activity to slow as we close in on 2024, the Fed is still performing their never-ending balancing act with the objective of taming inflation without casting the US economy into a recession. The Fed will have more data to digest as they are expected to receive one more job report as well as an inflation reading before their final meeting in December.

IRS Issues Proposed Regulations Regarding Long-Term Part-Time Employees

On Nov. 24, 2023, the Department of Treasury and Internal Revenue Service issued proposed regulations providing much-anticipated guidance regarding the "long-term part-time employee" (LTPTE) rules that the SECURE Act of 2019 (SECURE 1.0) first added to the Internal Revenue Code. The SECURE 2.0 Act of 2022 (SECURE 2.0) subsequently amended these LTPTE rules. The purpose of these rules is to allow certain LTPTEs who otherwise may have been excluded from a 401(k) or 403(b) plan based on the plan's service requirements, to participate in the plan for the purpose of making employee elective deferral contributions. The rules are complex, however, and the following Q&A's are intended to provide a high-level overview of the rules and recent IRS guidance.

Q1 What is a long-term part-time employee (LTPTE)?

A **Under SECURE 1.0, an eligible LTPTEs is defined as an employee who: (1) has attained age 21; and (2) has worked 3 consecutive 12-month periods after December 31, 2020 during which they have performed at least 500 hours of service, but less than 1,000 hours of service, each year.** SECURE 1.0 applies only to 401(k) plans and, since any 12-month periods beginning before January 1, 2021, can be disregarded for eligibility purposes, the earliest date that an eligible an LTPTE must be permitted to participate in a 401(k) plan is **January 1, 2024**.

Under SECURE 2.0, the definition of an eligible LTPTE was expanded to include both 401(k) plans and 403(b) plans covered under ERISA. In addition, the service requirement for an LTPTE is reduced to 2 consecutive 12-month periods during which an employee performed at least 500, but less than 1,000 hours of service, and any 12-month periods beginning before January 1, 2023 can be disregarded. Under this definition, unless an employee met the definition of LTPTE under the SECURE 1.0 definition noted above, the earliest date that such employee must be permitted to participate in a 401(k) or 403(b) plan is **January 1, 2025**. Please note, the SECURE 2.0 definition of LTPTE will be the prevailing definition going forward.

Q3 Our company employs part-time employees, some of whom do not work a sufficient number of hours to satisfy the eligibility conditions to participate in the plan. What are our options under the rules?

Q **Essentially, you have two options.** You can avoid having to comply with the LTPTE rules altogether by amending your plan to include eligibility provisions that are more liberal than the LTPTE rules, or you can apply the LTPTE rules. Certain employers may find one option more advantageous than the other depending on the relevant circumstances and plan design considerations. We encourage employers to contact their USI Consulting Group representative/consultant for additional information on how these rules affect your plan.

Q4 May a plan exclude certain classifications of employees from plan eligibility?

A **Yes, subject to IRS coverage and non-discrimination testing rules, and certain provisions of the tax code, exclusions based on certain classifications are allowable as long as the classification does not impose an impermissible age or service requirement.**

Q2 Our company employs part-time employees. However, the plan currently allows all employees to participate in the plan regardless of the number of hours that they work during the year, or has an eligibility provision that is more liberal than the requirements under the LTPTE rules. Do these rules affect our plan?

A **No, these rules only apply to plans that currently have eligibility requirements that require a minimum period of employment that would exclude LTPTEs as defined above.**

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Q5 What rules apply to LTPTEs after they become eligible for the plan?

A **The law provides numerous special rules that a plan may apply, or in some cases, must apply to employees who participate in a plan solely due to the LTPTE rules. LTPTEs who are covered by these special rules:**

- Must be eligible to make employee elective deferral contributions to the 401(k) or 403(b) plans;
- May be excluded from employer contributions. However, employers can certainly make matching contributions or non-elective contributions to LTPTEs if they choose to do so;
- May be disregarded for determining whether a plan satisfies its IRS 410(b) coverage test;
- May be disregarded for purposes of the average deferral percentage (ADP) and average contribution percentage (ACP) tests, including for purposes of being entitled to receive ADP test safe harbor contributions;
- Are not required to receive any minimum top-heavy contributions (although they are included when calculating the top-heavy ratio) but are not subject to any special rules regarding the application of the top-heavy exemption for safe harbor plans and;
- Must be credited with a year of vesting service for vesting computation periods during which they are credited with at least 500 hours of service (instead of 1,000 hours).

Q6 How do the vesting rules apply to LTPTEs?

A **LTPTEs must generally earn vesting credit for any year that they complete at least 500 hours of service.** So, LTPTE employees earn vesting for 500 hours of service in a vesting computation period (instead of 1,000 hours), and this will apply to all current and future employer contributions (even if the employee isn't eligible for employer contributions until completing more than 500 hours of service). Furthermore, if the LTPTE earns 1,000 hours of service (or otherwise begins participating for reasons other than LTPTE status, such as more liberal eligibility requirements), the employee must continue to earn years of vesting service under the 500-hour rule. Essentially, for purposes of counting vesting, service will accrue more rapidly for LTPTEs from their initial date of hire than non-LTPTEs and such enhanced vesting will continue to apply even if they later cease to be an LTPTE.

Q7 How do the LTPTE rules impact Safe Harbor Plans?

A **The recent IRS guidance clarified that plans are not required to provide Safe Harbor Contributions to LTPTEs.** However, safe harbor plans with a service-based eligibility condition may have a number of administrative and design issues to consider. Additionally, in some cases supplemental notices may be required to revise information that may have been provided in the annual safe-harbor notice to clarify rules applicable to LTPTEs.

Q8 Our plan currently has auto-enrollment for eligible employees. Do we need to include LTPTEs in the auto-enrollment provisions.

A **No, LTPTEs may be excluded from auto-enrollment provisions of the plan.** In general, a plan can determine the entry dates for LTPTEs as long as they are at least as frequent as semi-annually. Further, plans can require that LTPTEs make affirmative deferral elections. Finally, supplemental notices may be required to revise information that an administrator may have provided in an earlier auto-enrollment notice to clarify rules applicable to LTPTEs.

Next steps:

For 401(k) plans, the first eligibility date (January 1, 2024) for some LTPTEs is fast approaching. Plan sponsors of both 401(k) and ERISA 403(b) plans that employ long-term part-time employees are encouraged to contact their USI Consulting Group representative/consultant to help review their plan design and enrollment features and to set-up internal processes and procedures to ensure compliance with these new requirements.

Retirement Resources for You

USI Consulting Group's team of experts is happy to assist employers with all retirement plan compliance matters and changes in the market, including those discussed here, to help you mitigate risk and financial impact to your organization.

To learn more, please contact your local USICG representative, visit our **Contact Us** page or reach out to us at **information@usicg.com**.

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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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