MARKET & LEGAL UPDATE

April 2020 REVIEW

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"Global Markets Rally with the Economy Ready to Re-Start its Engine"

Despite world economies being shuttered and forced into a mass hibernation, a disturbing record rise in unemployment, an all but certain recession on the horizon, and the lingering effects of social distancing from the coronavirus, global markets came roaring back in April with the S&P 500 posting its best month since January 1987. After major U.S. stock markets set a record for the fastest drop of more than 30% between February 19th and March 23rd, the S&P 500 sharply rebounded by gaining 34% since the low. Major U.S. stock indexes posted double-digit gains during April with more modest gains in international markets. Unprecedented fiscal and Fed stimulus, optimism for slowly reopening the economy, and ramped-up efforts by pharmaceutical companies and billionaire philanthropists to develop therapeutics and vaccines for the novel virus have provided optimism to global markets. Markets tend to be forward-looking despite the obvious headwinds, such as massive declines in economic activity, S&P earnings growth plummeting, extreme supply and demand shocks, and the U.S. accounting for about 1.1 million of the 3.3 million world-wide virus cases reported (or 1/3 of the cases as of April 30th).

U.S. Gross Domestic Product (GDP) declined by an annualized 4.8% during the first quarter, the fastest pace since the 2008 crisis, which marks the likely start of a recession. Two quarters of declining GDP activity define a recession, and it is widely forecasted that the second quarter contraction will be much deeper. The Congressional Budget Office estimates that the U.S. economy could shrink by 12% in the second quarter, which translates to an annualized drop of 40% and projects similar drops in Europe and Japan. JP Morgan expects a deeper second quarter drop with U.S. GDP regaining its footing with an 11% increase in the third quarter. In comparison, China, the world's second largest economy, saw its first quarterly GDP decline ever (6.8%) since the International Monetary Fund began recording data in 1990, but JP Morgan expects a sharp rebound with China GDP potentially rising by 58% in the second quarter, and 25% during the third quarter.

Market Return Indexes	April 2020	YTD 2020
Dow Jones Industrial Average	11.2%	-14.1%
S&P 500	12.8%	-9.3%
NASDAQ (price change)	15.5%	-0.9%
MSCI Eur. Australasia Far East (EAFE)	6.5%	-17.8%
MSCI Emerging Markets	9.2%	-16.6%
Bloomberg Barclays High Yield	4.5%	-8.8%
Bloomberg Barclays Aggregate Bond	1.8%	5.0%
Yield Data	**April 30 2020**	**March 31 2020**
U.S. 10-Year Treasury Yield	0.62%	0.69%

A key driver of U.S. GDP is consumer spending, which fell sharply with the economy shut and mounting job losses. Unemployment claims over the last 6 weeks totaled over 30 million, the worst period by far in U.S. history. The unemployment rate (now at 12.4%) is expected to soon rise to over 20%, a level not seen since the Great Depression, when just two months ago it was at a 50-year low of 3.5%.

The U.S. Treasury passed a fourth relief package of $484 billion, with the budget deficit rising to $3.8 trillion, or 18.6% of GDP, the highest since 1945, according to the Committee for a Responsible Federal Budget. Federal debt, the net total of prior deficits, could rise to 106% of GDP by 2022, which would equal a record set in 1946. The massive stimulus packages, while necessary to support the economy, have potential future consequences that could lead to future inflation. However, with the federal funds rate near zero and 10-year treasury yields at record lows (well below 1%), government debt financing at this massive scale is more manageable. In five years, the markets expect the fed funds rate at 1%, half of what was expected at the beginning of the year. The U.S. central bank's portfolio of bonds, loans, and programs are currently at $6.6 trillion and are expected to balloon to between $8-$11 trillion from under $4 trillion in 2019. The central bank's expected new portfolio size will be twice as large as the one during the 2007-09 financial crisis, far exceeding the Great Depression or World War II era. While this is the highest level on record, many of the lending programs and swap lines that the fed has launched are self-liquidating, as loans are paid back, the size of the balance sheet is expected to shrink. The Fed's "do whatever it takes" approach has been lending widely to businesses, states, and municipalities to support the U.S. economy during the pandemic. To put the Fed bond buying into perspective, it has purchased $79 billion daily of treasury and mortgage-backed securities between March 16th and April 16th. By comparison, the Fed only bought about $85 billion a month between 2012 and 2014 during its quantitative easing program. The Fed provided several backstops never done before, such as supporting the corporate bond market to prevent credit from going sour to mitigate potential bankruptcies and further job losses. Further, the $600 billion Main Street Lending Program provides Fed loans directly to small and midsize businesses, last done during the Great Depression.

Since the end of April, about one quarter of the S&P 500 companies have reported actual financial results for Q1 2020. About 60% of the companies reporting have beaten earnings projections, but this percentage is below the five-year average. S&P 500 companies are on track to report their worst drop in earnings since 2009, with a decline of nearly 16% from a year earlier. The variance is wide by industry with "essential" sectors such as communication services and consumer staples showing modest earnings gains so far, compared to the most adversely impacted sectors such as energy, which declined by 65% during the quarter. The supply and demand shock has been staggering, with oil companies running out of room to store oil, pork farmers bottle-necked with their livestock and faced with difficult decisions due to 20% of the nation's meat plant closures, and the nightmare of millions of gallons of keg beer going stale and likely being dumped due to major event and restaurant closures.

It can be difficult for investors to "stay the course" when markets are as volatile as they were during March, with average daily moves of plus or minus 5% not seen since the Great Depression. This is a reminder that it has always been difficult for investors of all skills to effectively time the market. Despite the economic headwinds, markets are forward looking and there is some optimism of the advancements by Gilead, Moderna, Johnson & Johnson and other health companies worldwide to combat the virus. There is optimism that more U.S. states will gradually reopen their economies in May, which began in late April. Testing has been improving with experts wanting to see more than 4 million people tested per week nationwide. The private sector has ramped-up production of vital medical supplies such as 3M, Medtronic, even General Motors, to have the nation better prepared for a possible second wave of the virus this fall. Google and Apple have been working collaboratively to develop a vital virus tracking software. The world is aligned in its effort to destroy the invisible enemy and we cannot have the economy shut much longer. Two of the top five worst trading days in the Dow's 100 plus year history occurred during March but was followed by two of the top 10 largest weekly gains in late March and in early April. While a recession looms and much economic uncertainty remains, there is optimism that the pandemic curve will flatten, Fed and fiscal stimulus will support the economy, and the world's most innovative health and technologies will eventually prevail.

LEGAL UPDATES

Paycheck Protection Program: Retirement Plan Considerations

Many small employers have applied for the Paycheck Protection Program (PPP) under the CARES Act. However, the initial $349 billion allocated by Congress to the PPP quickly ran out. In response, Congress passed the Paycheck Protection Program and Health Care Enhancement Act (the "PPP and HCE Act") which became law on April 24, 2020. The PPP and HCE Act infused an additional $310 billion into the PPP. Small employers who have applied or intend to apply and have received or expect to receive a PPP loan, should be aware of certain retirement plan considerations.

By way of background, the PPP seeks to help small businesses affected by COVID-19 retain their employees and keep their businesses operating during this difficult time by granting loans which may be forgiven, provided the loan is used to cover certain expenses such as payroll costs. The CARES Act states payroll costs can include retirement benefits, and the Small Business Administration (SBA), in consultation with the Internal Revenue Service (IRS), have issued FAQs indicating that employer contributions to both defined contribution plans and defined benefit plans may be included in payroll cost. However, such contributions must be made within the 8-week period following the loan disbursement, as required by PPP loan guidelines. In other words, any employee or employer contributions made within the 8-week period following the disbursement of a PPP loan to a small employer will likely be considered payroll costs, but any retirement contributions paid outside of the 8-week period will not be included in payroll costs, and may not qualify for the PPP loan forgiveness.

Plan sponsors should be proactive and review their plan documents and current employer contribution funding requirements to determine if they need to make changes and amendments to their plans in order to have the retirement contributions count toward the forgivable payroll costs. For example, plan sponsors who previously were considering stopping or suspending matching contributions to their defined contribution plan, and who received a PPP loan may wish to consider continuing to make these contributions, at least through the 8-week period. Plan sponsors who typically wait until year-end to make matching contributions or discretionary profit-sharing contributions and/or have a "last day" allocation requirement, may need to reconsider their current plan design and amend their plans in order to make these contributions within the 8-week period so they may qualify for the PPP loan forgiveness.

Please note that the IRS has recently clarified that no deduction is allowed under the Internal Revenue Code for an expense that is otherwise deductible if the payment of the expense results in forgiveness pursuant to the PPP loan provisions of the CARES Act.

Conclusion:

While no formal IRS guidance has been provided regarding the forgivable payroll retirement costs, it appears that by funding retirement plan contributions during the 8-week covered period, plans sponsors will increase their eligible payroll costs used to determine the forgiveness of their PPP loan. Small employers who have received or expect to receive a PPP loan should review their retirement plans to determine what contributions may be included in their forgivable payroll costs under the PPP.

If you have questions or would like further information about this topic, please contact your USI Consulting Group representative.

For previous market commentaries please click here.

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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.

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