

Q4 2018

Qualified Plan News

December 2018 Capital Markets Review

Index	Period Ending December 31, 2018					
	Qtr	Ytd	1 Yr Return	3 Yr Return	5 Yr Return	10 Yr Return
S&P 500	-13.52	-4.38	-4.38	9.26	8.49	13.12
Russell 2000	-20.20	-11.01	-11.01	7.36	4.41	11.97
Russell 3000 Value	-12.24	-8.58	-8.58	7.01	5.77	11.12
Russell 3000 Growth	-16.33	-2.12	-2.12	10.85	9.99	15.15
MSCI ACWI Ex U.S.	-11.46	-14.20	-14.20	4.48	0.68	6.57
Barclays U.S. Aggregate Bond	1.64	0.01	0.01	2.06	2.52	3.48
T-Bills	0.57	1.86	1.86	0.99	0.60	0.35

Capital Markets Overview

In Q4 2018, the U.S. equity market posted its lowest quarterly return since Q3 2011, declining 14.3%. Despite broadly favorable economic data, investors grew concerned about the escalating trade war with China and the impact it would have on corporate earnings and global growth. In addition, rising short-term interest rates during the quarter added flattening pressure to the yield curve and raised doubts about the resiliency of the economic cycle. A partial government shutdown toward the end of December provided no relief to investor sentiment, which had already soured on existing geopolitical concerns. Investors also reacted negatively to the decline in oil prices during the quarter, which dropped over 30%.

The U.S. equity market returned -5.2% for the full year. All capitalization segments of the market declined in the quarter, with small-cap stocks trailing both the mid- and

large-cap segments of the market. For the year, large-cap stocks posted a return of -4.4%, outperforming small- and mid-cap stocks by approximately 6.6% and 4.7%, respectively. Value stocks reversed the trend of the previous seven quarters and outperformed their growth counterparts by 4.1% in Q4. Fears of a slowing global economy weighed on earnings growth prospects, especially for sectors such as technology and consumer discretionary, which are a significant portion of the growth segment of the market. Despite lagging in the quarter, growth stocks outperformed value stocks by 6.5% for the one-year period.

International equities returned -11.5% in the quarter. U.S. interest rate increases supported the U.S. dollar relative to most currencies, which negatively impacted international equity returns for U.S.-based investors. Slowing Chinese economic growth, tightening financial conditions, and heightened

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geopolitical tensions contributed to poor equity returns in most regions. Chinese economic growth slowed to the lowest level in almost a decade as authorities have continued to curb excess leverage and transition to a more consumer-oriented economy. The Chinese government began to employ both monetary and fiscal stimulus to encourage growth and counter the negative effects of an escalating trade war with the U.S. European markets declined due to political instability, including the U.K. and the European Union's inability to reach a Brexit withdrawal agreement ahead of the March 2019 deadline, as well as weakening manufacturing data, which is largely an effect of slowing Chinese growth. Plummeting oil prices led to oil-importing countries outperforming oil-exporting countries, while declining long-term U.S. interest rates also helped to alleviate future borrowing costs for countries with higher levels of debt.

U.S. government and agency mortgage issues were the strongest segments of the fixed income market as investors sought safety and quality as an alternative to the equity markets in the period. T-bill yields increased as the Federal Reserve raised short-term interest rates by 0.25% in December, the ninth rate hike of this tightening cycle. Long-dated government bonds returned 4.2% in the quarter as investors sought safety from declining equity markets, but fell 1.8% for the year as interest rates moved higher overall. The bellwether 10-year Treasury yield decreased 0.36% in the quarter to end at 2.69%. TIPS fell 0.4% during the quarter due to softening inflation expectations. Investment-grade credits were flat for the quarter, while high yield corporates declined 4.5%. Municipal bonds posted a positive return. Developed non-U.S. government bonds increased 1.6%, and emerging market bonds returned 2.1%.

Check Fiduciary Liability Coverage

Employers that sponsor 401(k) and other defined contribution retirement plans should review their fiduciary liability policies to make sure they provide adequate protection. Keep this helpful information in mind when you check your coverage.

Fidelity Bonding Is Not Fiduciary Liability Insurance

Retirement plan fiduciaries face personal liability exposure that will not be protected by a fidelity bond. The pension law (ERISA) generally requires that every fiduciary of an employee benefit plan and any other person who handles plan money be covered by a fidelity bond. The fidelity bond protects the retirement plan against misappropriation of funds by individuals handling the plan's assets. However, the fidelity bond does not protect against claims for losses sustained because of a breach of fiduciary duty.

Fiduciary Liability Insurance Protection

Fiduciary liability insurance provides protection for trustees and other plan fiduciaries in the event of a breach of fiduciary duty. These policies typically cover settlements or judgments. Wrongful acts that may be covered by fiduciary liability insurance include:

- Negligent investment practices
- Failure to diversify investments
- Failure to file required reports
- Conflicts of interest
- Errors in computing eligibility
- Inadequate instructions to beneficiaries that cause a loss of benefits

Plan Sponsors Ask...

Q: Sometimes employees ask us for advice about how much of their income they should be saving for retirement, how much they should already have saved, and how much they will need. Of course, we don't give blanket answers. But we would like to pass along some resources, either directly or through our plan communications, so they can educate themselves. Can you suggest some?

A: We're glad that you aren't trying to give one-size-fits-all answers to these important questions, and that you're interested in helping participants learn more. There are some great resources available online, and you may want to share them with your participants as you communicate about the plan. Be cautious in your communication, though, because the ideas presented by one provider or expert can vary widely when compared to another source. You do not want it to appear that you are endorsing any particular source—unless you have the backing of the plan's counsel and a full understanding that that's what you're doing. In a quick online search, we turned up resources from [Investopedia](#), [NerdWallet](#), [AARP](#), and the Motley Fool, among many others. Your plan provider likely has calculators available for participants, along with a variety of other tools. Take advantage of them. Even the [IRS has resources](#) that can help.

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The benefit plan itself can purchase fiduciary liability insurance. However, the policy must allow the insurer to seek recourse against the fiduciary if it is determined that the fiduciary breached his or her duty to the plan. Commonly, the employer purchases the insurance as part of the overall compensation package of company executives who assume responsibility over the company's benefit plan.

Check Coverage Carefully

Fiduciary liability insurance coverage varies widely from policy to policy, so it's important to check what is covered in your policy and determine if you need additional coverage.

Occurrence or claims-made policies. Most policies are claims-made policies that only cover claims made and reported during the policy period. Look to obtain an occurrence-basis policy that covers all acts that occurred during the policy period, no matter when claims are made.

Aggregation of wrongful acts. If "wrongful act" is defined vaguely in a policy, insist upon a clear, objective definition. A wrongful act is generally defined as a breach of duty under ERISA, another federal law, or state law. And, if multiple wrongful acts may be treated as part of an interrelated series of wrongful acts, negotiate the elimination of this provision. Otherwise, this aggregation provision may allow the insurer to allocate a new claim as part of a prior claim, which may limit what is paid on the claim (in the event that the policy's annual limit is unavailable to pay the claim).

Nonrecourse riders. If the policy is purchased with plan assets, the policy must allow the insurer to recover any paid losses from the fiduciary whose breach caused the loss. To protect themselves, individual fiduciaries can purchase nonrecourse riders. Under a nonrecourse rider, the insurer waives its subrogation rights against the fiduciaries in cases that do not involve fraud, willful neglect, or criminal wrongdoing.

Defense costs. To help ensure adequate defense coverage, fiduciaries may want to purchase a separate defense policy, since many policies count any costs of defending an action against the overall policy limit. Also, a policy may require you to accept defense counsel appointed by the insurer. Purchasing

a separate defense policy will allow you to name your own defense counsel.

Punitive damages or fines. Since most policies will not pay punitive damages, you may want to negotiate coverage of punitive damages. Even if a policy covers the 20% penalty tax on fiduciary violations, it may not cover the 15% initial excise tax on prohibited transactions.

Staying on Track and Planning Ahead: Plan Sponsor Calendar

Consult your plan's counsel or tax advisor regarding these and other items that may apply to your plan.

January

- Send payroll and employee census data to the plan's recordkeeper for plan-year-end compliance testing (calendar-year plans).
- Audit fourth-quarter payroll and plan deposit dates to ensure compliance with the Department of Labor's rules regarding timely deposit of participant contributions and loan repayments.
- Verify that employees who became eligible for the plan between October 1 and December 31 received and returned an enrollment form. Follow up for forms that were not returned.

February

- Update the plan's ERISA fidelity bond coverage to reflect the plan's assets as of December 31 (calendar-year plans). Remember that if the plan holds employer stock, bond coverage is higher than for non-stock plans.
- Issue a reminder memo or email to all employees to encourage them to review and update their beneficiary designations for all their benefit plans.
- Review and revise the roster of all plan fiduciaries and confirm each individual's responsibilities and duties to the plan in writing. Ensure that each fiduciary understands his or her obligations to the plan.

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March

- Begin planning for the timely completion and submission of the plan's Form 5500 and, if required, a plan audit (calendar-year plans). Consider, if appropriate, the Department of Labor's small plan audit waiver requirements.
- Review all outstanding participant plan loans to determine if there are any delinquent payments. Also, confirm that each loan's repayment period and the amount borrowed comply with legal limits.
- Check bulletin boards and display racks to make sure that posters and other plan materials are conspicuously posted and readily available to employees, and that information is complete and current.

Web Resources for Plan Sponsors

Internal Revenue Service, Employee Plans

[irs.gov/ep](https://www.irs.gov/ep)

Department of Labor, Employee Benefits
Security Administration

[dol.gov/ebsa](https://www.dol.gov/ebsa)

401(k) Help Center

[401khelpcenter.com](https://www.401khelpcenter.com)

BenefitsLink

[benefitslink.com](https://www.benefitslink.com)

PLANSPONSOR

[plansponsor.com](https://www.plansponsor.com)

Plan Sponsor Council of America

[pasca.org](https://www.pasca.org)

Employee Benefits Institute of America

[ebia.com](https://www.ebia.com)

Employee Benefit Research Institute

[ebri.org](https://www.ebri.org)

S&P 500 is a commonly used measure of common stock performance. Russell 2000 is a commonly used measure of small capitalization stocks. Russell 3000 Value measures performance of U.S. equity universe broad value segment with lower price-to-book ratios and lower forecasted growth values. Russell 3000 Growth measures performance of Russell 3000 Index companies with higher price-to-book ratios and higher forecasted growth values. MSCI ACWI EX U.S. tracks 850 stocks traded in 22 world markets (excludes U.S. based stocks). Barclays U.S. Aggregate Bond Index tracks domestic investment grade bonds (including corporate, government, and mortgage-backed securities). Citigroup 3-Month U.S. Treasury Bill Index tracks short-term U.S. government debt instruments. All referenced indices are unmanaged and not available for direct investment. Past performance is not a guarantee of future results.

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