

Q3 2021

QUALIFIED PLAN NEWS

CAPITAL MARKETS REVIEW			PERIOD ENDING SEPTEMBER 30, 2021			
Index	Qtr	Ytd	1 Yr Return	3 Yr Return	5 Yr Return	10 Yr Return
S&P 500 TR USD	0.58	15.92	30.00	15.99	16.90	16.63
Russell 2000 TR USD	-4.36	12.41	47.68	10.54	13.45	14.63
Russell 3000 Value TR USD	-0.93	16.58	36.64	9.94	10.94	13.48
Russell 3000 Growth TR USD	0.69	13.49	27.57	21.27	22.30	19.40
MSCI ACWI Ex USA NR USD	-2.99	5.90	23.92	8.03	8.94	7.48
Bloomberg US Agg Bond TR USD	0.05	-1.55	-0.90	5.36	2.94	3.01
FTSE Treasury Bill 3 Mon USD	0.01	0.03	0.06	1.14	1.13	0.60

MARKET COMMENTARY

The U.S. equity market returned -0.1% in the quarter. Strong corporate earnings and a drop in treasury yields contributed to U.S. equity returns through August, especially for the growth segment of the market; however, the early gains reversed by the end of September as concerns over rising inflation, slowing growth, and expectations of increasing interest rates weighed on investor sentiment and sent stocks lower to end the quarter flat.

Large-cap stocks outperformed both the mid- and small-cap segments of the market in the quarter. All capitalization segments of the market posted strong returns in the year-to-date period, with large-cap stocks outperforming mid- and small-cap stocks by 0.7 and 3.5 percentage points, respectively. Growth stocks outperformed value stocks by 1.6 percentage points in the quarter. Despite trailing in the quarter, value stocks exceeded growth stocks in the year-to-date period by 3.1 percentage points.

The financial services sector posted the strongest return in the quarter as expectations of increasing interest rates and a steeper yield curve raised the prospects of higher profitability. The energy sector continued to outperform all other sectors in the year-to-date period due to rising demand for oil and natural gas and recent supply constraints. The industrials and materials sectors posted the weakest returns in quarter. These two economically sensitive sectors were negatively impacted by investors' concerns of slowing global growth.

International equities declined 3% in the quarter. Despite a continuing global economic recovery and supportive monetary and fiscal policies, concerns over the economic implications of the spread of the coronavirus delta variant and regulatory uncertainty in China led to negative returns in most regions. Chinese equities declined by 18.2% in the quarter as the country tightened restrictions across a wide range of industries, including private education, technology, cryptocurrency, and gaming. Chinese markets were further stressed to end the quarter as investors grew concerned about the default of Evergrande, a large heavily indebted Chinese real estate developer, and the potential of spillover effects on the broader economy. European economic activity was supported by the lifting of many travel and social restrictions but concerns over supply chain disruptions and escalating energy prices led to negative equity returns in most European countries.

Preliminary estimates from a subset of core real estate managers indicate a strong positive return for the quarter. Over the last year, industrial and multi-family properties have performed better than holdings within the office and retail segments of the market.

The U.S. fixed income market returned 0.1% in the quarter. At its last meeting, the Fed indicated it was likely to taper its monthly asset purchases later in the year and potentially raise interest rates next year upon completion of the tapering. The Fed also updated its economic projections, forecasting slower growth and higher inflation for 2021 and 2022. The 10-year Treasury yield increased from 1.45% to 1.52% during the quarter. Investment grade credits experienced a flat return, while non-investment grade corporate bonds rose 0.9%. Developed non-U.S. government bonds were flat in the quarter on a local currency basis but declined 1.1% for U.S. based investors due to the U.S. dollar strengthening. Emerging market bonds were down 0.7% in the quarter.

401(K) PLAN DEFAULT INVESTMENTS – DON'T SET AND FORGET

Although most 401(k) plans give employees a broad choice of investments, they also provide a default investment for employees who haven't made active investment elections. When reviewing their plan's investment lineup, plan sponsors will want to ensure that their plan's default investment satisfies U.S. Department of Labor (DOL) "qualified default investment alternative" (QDIA) standards and remains an appropriate investment vehicle for employees' retirement savings. Plan sponsors that comply with the investment, notice, and related fiduciary duties listed in the DOL's QDIA regulation will not be liable for any investment losses that occur as a result of a participant's account being invested in a QDIA.



Use of the Default Option

Employees who are automatically enrolled in a retirement plan are moved into the plan's QDIA when they fail to make an investment election for their account. In addition to automatic enrollment, other situations that can result in participant accounts being moved into a QDIA include enrollment forms that are incomplete, qualified domestic relations orders, investment option removals, and rollovers.

Ten years ago, the most common default investment options were money market and stable value funds. At the time, employers regarded these funds as "safe" investments for those employees who had not provided instructions on how their retirement account assets were to be invested. Under current DOL regulations on QDIAs, the focus is primarily on target date funds, professionally managed accounts, and balanced funds.

Notice Requirements

Plans that use a QDIA for investments made on behalf of employees and plan beneficiaries who fail to direct the investment of their 401(k) plan account balances must provide a QDIA notice. The notice must be provided at least 30 days before they are eligible to participate in the plan or the first investment in a QDIA is made on their behalf (or on or before the date of eligibility if they have the opportunity to withdraw investments from the QDIA within 90 days of the first deposit). They also must receive an annual QDIA notice within a reasonable period of at least 30 days before the beginning of each plan year.

The QDIA notice must explain the employee's rights under the plan to designate how his or her contributions will be invested and, if he or she doesn't make any investment election, how the assets will be invested. The notice also must describe the QDIA, including the investment objectives, risk and return characteristics, and any fees and expenses involved. And it must explain the employee's right to transfer assets invested in the QDIA to other plan investment alternatives, as well as where to obtain information about other plan investments. Employees must be given a reasonable period after receiving the notice and before the beginning of the plan year to make investment choices.

Evaluating the QDIA

As is the case with any other 401(k) plan investment, the plan sponsor, as a plan fiduciary, is obligated to prudently select *and* monitor the plan's QDIA. For assistance, consult an experienced financial professional.

WHAT YOU SHOULD KNOW ABOUT BUY-SELL AGREEMENTS

If you are an owner of a closely held business, what would happen if you or a co-owner were to die suddenly? Whether a business is set up as a corporation, partnership, or limited liability company, major problems can result from the loss of one of the owners. How would the decedent's heirs liquidate the business interest to pay expenses and taxes? What would happen if an heir or an unknown outside buyer of the decedent's share decides to interfere with the business? Could the business or other owners afford to buy back the decedent's ownership interest?

Every business owner should consider these (and other) questions—and potential answers. An answer for many closely held businesses is a buy-sell agreement.





Advantages

This type of arrangement can provide many advantages for businesses facing the potential effects of an owner's death. For example, a buy-sell agreement can:

- Guarantee a purchaser for a potentially difficult-to-market asset (the deceased owner's share of the operation)
- Provide liquidity to a deceased owner's estate
- Protect the remaining shareholders or partners from unwanted interference in the business from heirs or third parties to whom an heir might sell the decedent's business interest
- Peg the value of the deceased owner's business interest for federal estate tax purposes (either by setting a value or providing a way to determine the value)

Three Varieties

Generally speaking, there are three types of buy-sell agreements. The first is a "cross-purchase" agreement. Under this approach, the owners agree to purchase each other's share of the business in the event of death. If there are many owners, this arrangement can get rather unwieldy. Under the second variation, called a "stock redemption" agreement, the owners agree that their corporation will buy a deceased owner's shares. With the third variation, a "combination" agreement, elements from the other two types of agreements are combined. For example, individual owners could agree to buy some of a decedent's shares, with the company buying the remainder.

Tax Traps

Regardless of which type of buy-sell agreement is chosen, certain key tax issues should be addressed. If the buy-sell agreement is properly structured, it will fix the estate tax value of the decedent's share of the business, no matter what the fair market value of that interest might be. This can provide certainty in the owners' estate planning. However, there are many tax pitfalls to avoid, and failure to follow the tax law's rules can result in the loss of this tax advantage.

Moreover, even if a buy-sell agreement is set up so that the IRS will likely accept the agreed-on value as the estate tax value, there are other considerations that should be considered. For example, how will the agreement affect the tax and estate plans of the decedent's family and the remaining owners? By weighing all the factors, a buy-sell agreement can benefit all parties involved.

Funding of the buy-sell agreement also needs to be closely reviewed. Most buy-sell arrangements are funded by life insurance. Making sure that life insurance is properly utilized is a key element to securing all the tax benefits offered by the arrangement.

WEB RESOURCES FOR PLAN SPONSORS

Internal Revenue Service, Employee Plans

› irs.gov/ep

Department of Labor, Employee Benefits Security Administration

› dol.gov/ebsa

401(k) Help Center

› 401khelpcenter.com

BenefitsLink

› benefitslink.com

Plan Sponsor

› plansponsor.com

Plan Sponsor Council of America

› psca.org

Employee Benefit Research Institute

› 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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