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QUALIFIED PLAN NEWS

Q2 2022

CAPITAL MARKETS REVIEW					PERIOD ENDING JUNE 30, 2022	
Index	Qtr	Ytd	1 Yr Return	3 Yr Return	5 Yr Return	10 Yr Return
S&P 500 TR USD	–16.10	–19.96	–10.62	10.60	11.31	12.96
Russell 2000 TR USD	–17.20	–23.43	–25.20	4.21	5.17	9.35
Russell 3000 Value TR USD	–12.41	–13.15	–7.46	6.82	7.01	10.39
Russell 3000 Growth TR USD	–20.83	–28.15	–19.78	11.84	13.63	14.41
MSCI ACWI Ex USA NR USD	–13.73	–18.42	–19.42	1.35	2.50	4.83
Bloomberg US Agg Bond TR USD	–4.69	–10.35	–10.29	–0.93	0.88	1.54
FTSE Treasury Bill 3 Mon USD	0.14	0.17	0.19	0.61	1.09	0.62

MARKET COMMENTARY

The U.S. equity market ended the second quarter down 16.7%. The decline in stocks was primarily driven by the realization that interest rates will need to be raised higher than previously expected to tame inflation. While higher rates should reduce inflation, it may result in increased borrowing costs and a more difficult environment for businesses looking to expand.

Large-cap stocks outperformed both the mid- and small-cap segments of the market during the quarter. For the year-to-date period, large-cap stocks posted a return of –20.0% outperforming mid- and small-cap stocks by approximately 1.6% and 3.4%, respectively.

Growth stocks lagged value stocks by 8.4 percentage points for the second-consecutive quarter as rising longer-term bond yields continued to have a greater impact on growth stock valuations. Weak relative performance from the technology and consumer discretionary sectors detracted from growth stock performance; favorable relative performance from the utilities and consumer staples sectors were the primary drivers of the market's value segment.

International equities declined 13.7% during the quarter. Emerging market equities outperformed developed market equites for the first time since the end of 2020. China (+3.4%) was the only country with markets that posted a positive return during the period. Prolonged COVID restrictions showed signs of easing which raised the outlook for China's economic growth. However, China's market outperformance did not erase significant negative performance over the past 12 months; China's equities were down approximately 31.8%. Developed equities in Europe posted a –14.5% return in the second quarter driven primarily by concerns over natural gas shortages resulting from the Russia-Ukraine war.

Preliminary estimates from a subset of core equity real estate managers indicates positive returns in the range of 3%–6% for the quarter. Over the last year, industrial and multi-family properties have performed better than holdings within the office and retail segments – a trend that continued during the period.

The U.S. fixed income market returned –4.7% in the quarter. The Fed increased the target Fed Funds range 0.50% in May and 0.75% in June, ending the quarter at 1.50% to 1.75%. Additional rate increases are expected this year as the Fed attempts to lower inflation. The 10-year treasury yield ended the quarter at 2.98%, representing an increase of 0.66 percentage points during the period. In the year-to-date period, the BB Bond Aggregate index declined by 10.3%, indicating that the market has priced in recent rate increases and the anticipated additional increases of 0.75% to 1.00%. During the quarter, investment grade corporate bonds generated a –6.9% return and non-investment grade corporate bonds returned –9.8%. Municipal bonds declined 2.9% as rates rose across the yield curve. Developed non-U.S. government bonds returned –4.6% on a local currency basis but declined by 12.5% for U.S.-based investors due to weakening foreign currencies. Emerging market bonds were down over 11% during the quarter.

TIPS returned –6.1%, underperforming nominal treasuries during the quarter. Fed action caused inflation expectations to decrease as indicated by the breakeven inflation rate implied in 10-year U.S. TIPS, which ended the quarter at 2.33% versus 2.84% at the end of the first quarter. The realized annual CPI (inflation) was 8.5% as of May 31, 2022.

FAQs ABOUT REQUIRED NOTICES

There are certain notices employers must provide to their 401(k) plan participants before year-end. To help you prepare in the months ahead, we have compiled information about commonly required notices.

WHEN DOES THE SAFE HARBOR PLAN NOTICE HAVE TO BE DISTRIBUTED?

If your 401(k) plan has a safe harbor design, you must provide eligible employees with a written notice at least 30 days, and not more than 90 days, prior to the beginning of every new plan year. The notice must describe your plan's safe harbor provisions and the employees' rights and obligations under the plan.

For employees who become eligible to join the plan after the start of the year, a notice must be provided not more than 90 days before but no later than the date the employee becomes eligible. The safe harbor notice can be a stand-alone notice or combined with the automatic enrollment notice and/or with the qualified default investment alternative notice. For employers that want to combine notices, the IRS has a sample notice available on its website (www.irs.gov/pub/irs-tege/sample_notice.pdf).

WHEN DO WE NEED TO GIVE PARTICIPANTS NOTICE OF OUR PLAN'S AUTOMATIC ENROLLMENT FEATURE?

You must provide employees with an automatic enrollment notice upon hire, immediately before plan eligibility begins, and annually at least 30 days before the beginning of the plan year. The notice should explain the employee's right to decline automatic enrollment, make changes to the election amount, and opt out of the plan altogether. For example, the sample notice mentioned above meets the automatic enrollment notice requirements by explaining:

- To whom a plan's automatic enrollment features apply
- What amounts will be deducted from an employee's compensation and contributed to the plan
- What other amounts the employer will contribute to the employee's plan account
- When the plan account will be vested
- How the employee can change their contributions.

WHAT IF OUR PLAN USES A QUALIFIED DEFAULT INVESTMENT ALTERNATIVE (QDIA)?

Plans that use a QDIA for employees and plan beneficiaries who fail to direct the investment of their 401(k) plan account balances must provide a QDIA notice. Employees and beneficiaries should receive this notice 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 should:

- Explain the employee's rights under the plan to designate how contributions will be invested and, if they don't make any investment election, how the assets will be invested.
- Describe the QDIA, including the investment objectives, risk and return characteristics, and any fees and expenses involved.
- 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. The notice may not be provided in a summary plan description or a summary of material modifications. However, employers can provide the required description of the QDIA in a separate, simultaneously furnished document, such as the default investment's prospectus.

GROWING PAINS: STRUCTURAL CONSIDERATIONS FOR GROWING YOUR BUSINESS

Ask any small-business owner to identify the major challenges to growing their business, and chances are they'll say: winning more sales. For medium- or large-business owners the likely response would be structural growing pains — putting into place the necessary processes and structure to accommodate a higher volume of business. In fact, one of the most common reasons businesses plateau at a certain level is their inability — or unwillingness — to develop the structure needed for growth.

But aligning structural changes with sales growth is often more of an art than a science. The systems, processes, staff, and organizational changes needed to grow are ongoing and dictated by a myriad of factors such as the nature of the business, its capital requirements and, ultimately, customer demands. Nonetheless, certain structural growth concerns — excluding financing and office/production space issues — are shared among all growing companies and fall into three overall areas: organizational structure, policies and procedures, and systems/technology.

STAFFING/ORGANIZATIONAL STRUCTURE

Organizational structure is among the most common growing pain experienced by small companies. The needs of a company with 25 employees, for instance, is quite different than one with five. As an organization grows, so does the owner's number of direct reports. Over time, nothing can be done without involving the owner, creating a communications back log, and a barrier to growth. A telltale sign of such a situation is failure to make decisions needed to start projects. The best way to prevent this from happening:

- Trust your key employees and learn to delegate. Start by looking at where you are spending your time. You can still have final say on any important decisions, but you do not need to be involved with day-to-day issues that can prevent you from focusing on larger, more strategic matters.
- Formalize delegated authority with an organizational chart and job descriptions. These will help you better define functional expertise for a given job, for various departments across the organization, and provide the foundation for the growth of future personnel and key management staff.

Lack of functional expertise is another challenge faced by small companies. Too often, businesses fail to recognize that specific expertise is needed to grow. Small businesses are typically organized around the manager's area of expertise, such as marketing, accounting, or production. This often prevents the business owner from recognizing problems in other departments. It's a good idea to periodically solicit the opinions and insights of trusted business acquaintances and other experts. You can also form an advisory board for periodic feedback on strategic direction.

POLICIES AND PROCEDURES

For most smaller businesses, written policies and procedures are often nonexistent. But it is precisely this lack of documentation — and the thought that goes into it — that can restrict rapid growth. If your business is growing fast enough to require frequent additions to staff, formalized policies are a must for training purposes. Even if you are expanding at a moderate pace, documented policies will likely be necessary once you reach 20 or more employees.

What warrants a formal policy and what should be documented? This will depend on the nature of your business and the average skill level of employees. In general, it's a good idea to document:

- All HR policies in detail
- Expense approval authorization levels
- Inventory control policies
- Billing and collection procedures
- Operational policies that could materially affect your business if they went amiss.

An annual budget and sales projection, updated monthly, are also a necessity if you need to obtain outside funding or sell your company. Over time, consider putting together a comprehensive policy manual where employees can get answers to questions when decision makers are unavailable.

An informed and involved staff usually results in higher productivity. As your organization grows, you will also need to implement more formalized communications channels for employees and customers. Regularly scheduled employee meetings, periodic e-mail updates, and a cascade communications policy can help to ensure that your internal communication channels facilitate, not constrict, growth.

IS YOUR BUSINESS SUFFERING FROM GROWING PAINS?

Signs that structural changes may be needed:

- **Sales continue to grow but profits do not.**
- **Employees are working increasingly long hours.**
- **Staff spend too much time putting out fires.**
- **Inability to make decisions.**
- **There are no regularly scheduled meetings or employee communications.**
- **The "system" is constantly down.**
- **Aging equipment is not replaced.**

SYSTEMS/EQUIPMENT

Smaller businesses are often the last to upgrade to new technology, usually due to cost. Yet the price of not implementing improvements is usually much higher. Low productivity, frequent down time, and incompatibility with newer client systems can cripple a business that's poised for growth. There's also the matter of keeping up with your competitors both operationally and across product and service offerings.

The average computer becomes virtually obsolete in just three years, and most of the widely used software applications are updated every two years. Therefore, staying abreast of technological advances must be an ongoing endeavor. Start by working regular capital upgrade costs into your budget. Consider dedicating a full-time person to information technology (IT), if you don't already have one, and make sure they are current on the latest technological developments in your field. Even though you may not be able to afford all the latest equipment, you'll be on top of technology trends in the industry and know what your competitors are up to — or are capable of.

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.

Financial Concepts Inc.
(734) 214-9770 | finconcepts.com

M Financial Group | 1125 NW Couch Street, Suite 900 | Portland, OR 97209 | 503.238.1813 | fax 503.238.1815 | mfin.com