Please note: This is a transcription so there may be slight grammatical errors.

Hello and welcome to Revamping Retirement, a podcast brought to you by CAPTRUST, where we explore the opportunities and challenges facing today's retirement plan sponsors and fiduciaries. Our hosts, Jennifer Doss and Scott Matheson lead the employer sponsored retirement plan practice at CAPTRUST, one of the law largest registered investment advisors in the US and a thought leader in the retirement plan advisory and consulting space. We hope you enjoy Revamping Retirement.

Scott Matheson:

Well, hello everyone and welcome to another episode of Revamping Retirement. I'm Scott Matheson and I'm joined as always by my co-host Jennifer Doss. On today's episode, we're going to talk to our CIO chief investment officer, Mike Vogelzang once again. We will also be followed of course, by our Minute With Mike, Mike Webb. And then Jennifer's going to talk a little bit about recent legislative developments and how that could impact retirement plans in 2022 and into 2023. So without further ado, we'll welcome our chief investment officer Mike Vogelzang. Mike, thanks for joining us again.

Mike Vogelzang:

Hey Scott. Hey Jennifer.

Scott Matheson:

Well, since the last time we talked, Mike, the markets are, we'll call it a little, no, we'll call it very different since the last download you gave to us. We're going to hear talk about what you were right about, what you were wrong about, score you on that. Of course, I'm kidding.

Mike Vogelzang:

The first part's fine, Scott, the second part, there's nothing wrong so that would be a perfect score.

Scott Matheson:

I agree with you a hundred percent.

Mike Vogelzang:

Of course.

Scott Matheson:

All right. Well, speaking of what's different, can you start out by giving us a quick update on where the market is now and maybe even what your views are going forward?

Mike Vogelzang:

Yeah, well, you're right, it's a very unsettled environment for investors in general. The biggest change of course is the war in Eastern Europe and Russian invasion of Ukraine and how that's been going. And of course all the knock on effects of that, including higher oil prices and that's driving up the price of oil, of course, and then interest rates and so on. We've entered a much more challenging period for investors. And this comes at the end of almost a 20 year cycle of really a pretty benign period cycle for investors with much lower interest rates almost consistently across the board. You can't really go anywhere without talking about inflation. I'm sure we'll talk about that in a minute, but the big thing, two things, the interest rate and the 10 year US government bond is up almost over a hundred basis points or 1% of the year, so from roughly 150 to 250.

It's actually pushing 270 today. And that hurts the price of bonds and bond investors are getting whacked pretty hard. Of course on the no place to hide category, the stock market's also down about five or 6% year to date. So it has been a challenging first quarter and beginning of the year, and it's probably a good time to be fairly patient as an investor. We're not negative, we don't generally have a bearish outlook. But the way we think about this is that risks have risen. And what we mean by that as investors is that when the potential outcomes expand, there's a wider array of outcomes.

There could be things from all the way for the unthinkable nuclear war impact in Eastern Europe, all the way to we've got an election this year and all the things in between that. There's an enormously wide array of outcomes, and from potential recession in 2023 to use the R word, to the economy skipping through and rallying as we head into the end of the year. Again, wide array of outcomes equal higher risk, which means, hey, let's be a little more defensive here.

Jennifer Doss:

So Mike, you mentioned the bond market real quick there and rates. The bond market itself is having a rather, let's call it historic moment, and not necessarily in a good way. Can you maybe dig into that a little bit, tell us some background of what's happening and maybe why.

Mike Vogelzang:

Sure, yeah. Look, I want to try to paint a bit of a broader picture than what you'll read in The Wall Street Journal or see on CNBC every day for longer term investors and this is why we're being a little more patient, a little more defensive. Interest rates since the 80s have been going down. There's been a really long trajectory of lower interest rates and that's everything from annuity values to home mortgages, to credit cards, et cetera. In 1987, right before the crash of October of 87, interest rates, the 10 year treasury was almost 10%. Today, it's again, it got down to, at one point during COVID, it got down to under half a percent. So you've seen this huge long, almost 35 year cycle of lower, lower, lower, lower interest rates.

One of the ways we in the investment world think about rates is we use something called a moving average, that is how fast is something falling? And when you take the longest view, you can look at monthly moving averages, 200 month moving average, which is a really long period. The last time that the 10 year treasury was above its 200 month moving average was October of 1987. Think about that. Basically what it means is this moving average has been moving down along with interest rates for 35 years.

This morning, we actually broke above that 200 day moving average for the first time. That gives you a sense of the damage we've had in the bond market. This is one of the worst bond markets we've seen in probably 35 or 40 years, maybe the early 80s when we had a period of time when rates were moving up faster than this. Yeah, this is a bit of a historic moment as you said perfectly. And so, again, until some of this dust settles, we would suggest we'd just be a little more patient and quiet and take your time and it's not always a good time to be an investor. Sometimes it pays to be patient.

Jennifer Doss:

Gotcha.

Scott Matheson:

Oh, sorry, Jennifer. Go ahead.

Jennifer Doss:

No, I was going to say just for our listeners, today, this morning that he just referenced, it is April 8th.

Mike Vogelzang:

Sorry about that, yeah.

Scott Matheson:

Yes. Details. Details do matter. Real quick, you talk about a lot of the pressures and I know you guys are thinking all the time about what's the Fed doing to really abate or mitigate or thwart, we'll call it, inflation from getting out of control. And one of the things is we think back to our listeners, most of whom are going to be employers is obviously there's a lot of pressure in this labor market right now just given where we are and a lot of concern around is wage inflation keeping up? I think we're five and a half or so percent year over year, but we're still in this situation where, what is it, 10 million job openings or job postings in the US and certainly I think we tick back up from 3.6% to 3.8% unemployment with the first March reads.

We're still well above what most people would call full employment, around the 4% mark, which means that not only we have a lot of jobs to fill right now, but we're effectively chasing 0.2 to 0.4% of the population that doesn't even want to work. Interesting landscape for sure. But in light of all that, I guess, as you think about the employers that are out there, what are you guys thinking about with regard to the labor market and wage inflation and what kind of pressure all this puts on the Fed and the direction of rates going forward?

Mike Vogelzang:

Yeah, I think we're going to have a tight labor market for a while. I don't think that's going to change anytime soon. The way economists and investors think about labor is it's really an input into goods production, or into the GDP production. And so again, we're talking about sort of long term cycles here, which is difficult to do in the attention span of a podcast, but we're going to try. One of the things that since the late 80s or maybe 90s, certainly since the dot com crash in 2000, we've seen labor being on the back foot, that is capital had primacy, that is capital's cheaper, it's been dominating and labor's had a hard time getting their footing. Let me give you an example of what that means. Anywhere in the last 20 years, Walmart said, "We're going to get lower prices."

So they go to all of the people who put stuff on the shelves at Walmart and they say, "No, no, no, give us a 5% cut in prices. We want to pass on lower prices to our consumers." Great. Whether it's a television, whatever it happens to be. All of those producers will then go out and say, "Okay, where can we find the cheapest labor?" Because labor was plentiful, it was all over the world. You could move around from Vietnam to the Philippines, to Korea, to Alabama, wherever the best and cheapest value for labor was. And that created an incredible boon for consumers as prices fell, but it put labor in a really difficult bind because if somebody decided to unionize, the company would close the plant and move it somewhere else. We believe that the long cycle here is that that's beginning to reverse a little bit, that we're starting to see, right, we've seen Starbucks starting to unionize.

We've seen an Amazon warehouse unionize on Long Island. Some of that is those big wheels are turning today and saying, "Wow, labor now has the upper hand, and we're going to start demanding what we want." And so I think that big picture, this higher inflation longer term cycle is probably moving against a really broad array of labor supply, which means we'll probably have tight labor markets for a while. Now a lot of these things are micro. It's like all real estate's local, all labor is micro climate. What do you need? What kind of labor do you need? It really depends on your own circumstance. But I think generally as we view the market and the economy globally, we expect labor to remain tight for some time.

Scott Matheson:

Yeah, I was reading a study, I think SHRM did it, should probably not misattribute that, but pretty sure it was SHRM. And it was basically a round table of Fortune 50 CEOs and one of them said very astutely the access to financial capital is no longer a concern of there's whatsoever, but the access to human capital is their biggest threat to continue business success. So definitely see that shaping out. You're seeing it and a lot of our listeners are not just in terms of what are you doing with wages for sure, and what does that mean to wage compression across the board for you going forward, but what are you doing in the benefit space to rethink how you're spending even that fixed amount on dollars that you were spending before, plans a big part of it, marrying that up against the shifting needs and wants of the American workforce, which is arguably creating a new social contract, if you will, between employer, employee in the US that probably don't look like the past.

Maybe looks more like even what we've seen overseas in Europe in the future, but will be an interesting ride along the way for us as we do what we do, not only for our own workers, but also for all the employers we work with to try and make their benefit programs richer. Good stuff as always, Mike. Appreciate you spending the time with us here. I know you got to get back to staring at those stickers of where the interest rates are minute by minute.

Mike Vogelzang:

I'm sorry, did you say The Masters is on right now?

Scott Matheson:

I said, yes, I said, I know that Tiger tees off in... Never mind.

Mike Vogelzang:

In a while. No, no, there's plenty to do in the markets every day.

Scott Matheson:

Yeah, that's right.

Mike Vogelzang:

Appreciate the opportunity to be on Jennifer and Scott.

Scott Matheson:

Awesome. Well, we'll catch you soon. In the meantime, we're going to go switch over to our Minute With Mike Webb where Mike will talk about early retirement distributions and the rules that apply to them. So take it away, Mr. Webb.

Mike Webb:

Thanks Jennifer and Scott. Mike Webb here with another Minute With Mike. This minute focuses on a tax penalty associated with early retirement plan distributions or those taken prior to a participant turning 59 and a half. Let's break the rule down by plan type. For 403b and 401k plans, a tax penalty generally applies to early distributions taken in cash. Distributions that are rolled over to another retirement plan or IRA are not to subject to the penalty. Let's contrast that to 457b plans where early distributions, whether rolled over or not are not subject to the penalty. Now, when it comes to Roth plans, qualified distributions are both tax free and penalty free, but non-qualified distributions may be subject to taxes and the penalty on earnings on a prorated basis. Now let's talk about the penalty itself. The penalty is 10% of the amount distributed. The penalty is over and above the amount of income tax due on a distribution.

For example, let's say I normally pay 40% in total income taxes on a distribution. With the penalty, that amount increases to 50%. Thus the penalty can be a significant tax burden, particularly when large amounts of money are withdrawn. Fortunately, there are some exceptions. For example, if a participant terminates employment during or after a year in which they reach age 55, no 10% penalty applies. There are other exceptions as well, including distributions from the estate of a deceased participant, distributions due to disability, Roth conversions, qualified birth and adoption distributions, distributions to an alternate payee under a qualified domestic relations order and a series of substantially equal periodic payments following termination of employment for the longer of five years or until participant reaches age 59 and a half.

Note that this final exception used to be uncommon due to IRS rules that resulted in tiny payments of most individuals. However, the rules were changed in January, which means that we may see increased use of substantially equal periodic payments going forward, particularly for early retirees with larger account balances. Note that this list of exceptions is by no means exhaustive and retirement plan participants should always consult a tax professional as to whether or not the 10% early distribution penalty applies to their particular distribution. For Revamping Retirement, I'm Mike Webb and this has been your Minute With Mike. Now back to Jennifer and Scott.

Scott Matheson:

All right, well thanks Mike Webb. Well, Jennifer, this is the time where I get to interview you, my favorite part of the-

Jennifer Doss:

Perfect.

Scott Matheson:

Yeah, I know you're excited. It's my favorite part of the podcast that we do. Well, I'm going to start because in addition to all the market and economic activity that's been going on that Mike talked about, Mike Vogelzang, in late March, the House of Representatives passed the Securing a Strong Retirement Act of 2022, which we've been calling in the industry Secure 2.0, because in many ways, it's just a follow up to the first Secure Act that passed back in December of 2019. Why don't you give our listeners a little bit about the bill and maybe even what it means for retirement plans?

Jennifer Doss:

Sure. It did pass very recently on March 29th. It passed the House with a vote of pretty impressive 414 to five. Five people had some very differing opinion and we don't know why, but that's okay. It's very bipartisan, which is extremely rare as we all know in Congress. The bill will now move on to the Senate where the Senate's going to have hearings with their committees and there's going to be markups over the next few months, really setting it up for a conference with the House where they're going to go provision by provision. The general expectation is that the final bill that comes out of that conference is going to get attached to really some other type of legislation that's probably going to be by the end of the year. Fall would be probably the very earliest we'd see it. We're probably looking more like end of year like it did in the Secure act 1.0, like you said, where it just gets attached to a year end spending bill.

The Senate does have the, what we're calling the Portman Cardin bill, which is also the Retirement Security and Savings Act. So the two bills do have a lot of overlapping provisions, which is why we know that in some cases they're very much on the same page and we have some pretty good probability of getting a lot of these provisions through to the final bill.

Some of the ones that are maybe more likely and impactful to make it into that final version are, and things we've talked about in the past, but just as a reminder, the use of collective investment trusts within 403b plans, which is currently not allowed. And the ability for 403b plans to join pooled employer plans, or PEPs, which I'm sure everybody's been hearing about in the market, a clearing house for lost retirement accounts, and higher small balance automatic rollover amount, really from the current like $5,000 limit that's been in place for a very long time, higher catch up contributions, greater access to Roth, maybe including the ability to do an employer matching contribution as Roth for like the employee to elect that provision, and the treatment of student loan repayments as elective deferrals, really for the purposes of matching contributions.

There's been a lot of discussion about that in the industry as well. How can we help people that can't afford to maybe pay back their student debt and also save for retirement. There's obviously a lot more. There's like 50 provisions in there. The other big ones that you might hear talked about are raising the required minimum distribution, the RMD age again. We just raised it in Secure Act 1.0 to 72 from 70 and a half. And now they're talking about raising it again to 75.

They're also talking about mandating automatic enrollment and automatic escalation for any new retirement plans that are established. Those are the ones that are a little bit more up in the air because raising the RMD age is actually very expensive, costs government money the way that they calculate that. And historically really having any kind of mandate, even if it was just for new plans, is really something that's kind of tough to get over the goal line with both parties. I do also think that we'll get some sort of emergency savings legislation included in the final version, but what that looks like is really being very heavily debated right now.

Scott Matheson:

Yeah. Just curious, what was provision number 47?

Jennifer Doss:

Ooh, you got me.

Scott Matheson:

Well, it's worth a shot. I figured if anybody's going to know it's you. It's a lot of common sense provisions is what you end up hearing in there and it's been talked about for some time, which I know that we're a fan of so many of those, the 403b thing is befuddling, it's been for a long time. So hopefully there's a path to, as you say, get this thing over the hump. It will be interesting to see what the pay for as they call it is here, but take away tax dollars by increasing that RMD age, you got to make that up somewhere. So we'll be all tuned into that. That's one side of government that affects retirement plan sponsors. Obviously the regulatory sides the other, so any good updates there?

Jennifer Doss:

We do. There's always something going on I feel like on the regulatory side right now. We got a recent compliance bulletin regarding cryptocurrency. I'm sure people have seen the news on that, really the regarding cryptocurrency being available in defined contribution plans, in which the DOL, the Department of Labor pretty much came out and said, if you're offering this in either your core lineup or even within your self-directed brokerage account, we're going to be asking you some really tough questions about the prudence of that decision. So really threw a lot of cold water on that, for sure. Cryptocurrency is not really widely available or even used within the DC industry today, so the guidance itself really wasn't all that impactful for that specific reason. The really interesting part that came out of it was really the very last paragraph where the Department of Labor was talking about whether you should have it within the self-directed brokerage at account.

They were really questioning the prudence of even allowing that type of investment within that brokerage account. And the issue with that is that Department of Labors never really told plan sponsors like what are our expectations for you regarding self-directed brokerage selection, like should you be limiting things within there? And really without that guidance, this comment now creates a lot of confusion because you're kind of looking at this as a prudent fiduciary saying, "Well, should I be limiting the types of investments that I offer within self-directed brokerage? Should I be designating certain types of securities only?" If so, where does that cross the line if I start really narrowing that and limiting that down where does that cross the line into I'm designating these securities. And really that's where you start to be subject to monitoring and disclosure responsibilities, which is kind of against the purpose of having a self-directed brokerage account.

The industry's pretty interested in this topic right now. I think we're going to have to see if we do get any additional clarity from the Department of Labor. We may not on self-directed brokerage account as they're becoming more popular with many clients. And secondly, the other thing I'd mention on the regulatory front is we are still expecting the final ESG guidance from the Department of Labor sometime in May or maybe June, July.

There was some concern in the abundance of comments that were provided back to the Department of Labor with their proposed role, that it really plays too much emphasis on the environmental part or the E part of ESG and not enough maybe on the other parts of that. And it would suggest also that plan sponsors should maybe be considering ESG risks when evaluating and selecting investments, really implying that they should be doing so instead of they could be doing so. We'll have to see where they land on that stance as there was also some concerns in the industry about requiring that or promoting that to an extent without a lack of standardized data from the companies to base that analysis on. Although I will say the Security and Exchange Commission, the SEC, also recently proposed some standardization and disclosure of climate related metrics at the very least. So that would certainly go a long way towards helping that particular process.

Scott Matheson:

Yeah, well, I know firsthand from watching the work that you've been doing here internally with your team that getting some of that standardization, getting better data flow would certainly be a welcome change for us to be able to help more of our employer clients and even individual clients as it relates to navigating ESG, and certainly something that's more balanced across all of the letters of E, S and G is something that everybody wants. Great updates, Jennifer, as always. I don't know that our listeners really are aware of this, but in addition to being our defined contribution practice leader, Jennifer plays some leadership roles in the National Association of Plan Advisors, most recently has taken on the chair of government affairs for plan advisors. And I'm sure after listening to her talk, you're as happy as I am that she's the one having conversations with folks in DC to help shape so many of these potential laws and regulations.

Well, everybody thanks as always for tuning in. You've done it. You've reached the end of another episode of Revamping Retirement. And as you heard from Jennifer, no shortage of activity in our nation's capital to follow this year, which we'll be doing for you and updating you along the way. And as Mike Vogelzang certainly made clear, there's no shortage of market activity or economic activity, and as it relates to that, labor market activity for us to be updating you on throughout the rest of the year. If you do want more detail on our current market views, head on over to captrust.com, find our current investment strategy write up. And if you have feedback on our podcast, ideas for future episodes, please share it. We'd love to have it. And we'd also love it if you like what we're doing. And if you listen to us regularly, why don't you go and like and subscribe to our podcast in your favorite podcast app. Until next time, I'm Scott Matheson signing off for Jennifer Doss. Thanks for joining us.

VO Artist:

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