BIRCHWOOD
INVESTMENT
MANAGEMENT LTD
NEWSLETTER

October 2016

It's plain sailing...

How much income will you need in retirement?

Various survey findings have revealed a wide gap in the amount people expect to spend in retirement compared to the actual income they are likely to receive. Also, there is still confusion over what state pension they are entitled to with many overestimating the amount they expect to receive.

When the state pension was introduced in 1908, the average life expectancy was in the mid-40s. Today, based on people who are already 65 years old, the average life expectancy for women is around 86 and for men it is almost 84 years.

So with many people looking forward to a retirement of 20 years or more, it is never too early to start thinking about your financial security in later life. Realistically, a state pension may simply not be enough to give you the comfortable retirement lifestyle you would like.

State pension aside, probably the single most confusing aspect of any individual's personal financial affairs is the question of, how much a collection of different pension arrangements will provide in terms of retirement income when the time comes to stop work?

There's barely a week goes by where you don't read something in the press about pensions. Pension freedom has been with us for over a year now and there is more than ever a lot to think about when it comes to making choices as to what to do with an assortment of pensions that you will have to make decisions on.

In a recent report, Citizens Advice suggests that many people have not fully understood the tax implications of accessing all of a pension fund and a significant number have experienced a substantial tax charge that could have been reduced had they taken their benefits in a more measured way.

Out of your pension and straight into a bank account…

Another surprise from a recent survey report found that some respondents were found to be 'stashing' pension funds they had withdrawn and putting the money straight into a bank deposit account. For various reasons this may not be a good idea. Tax is the first reason, as money held within a pension fund may attract less tax than if it is held directly in a bank account. Whereas, interest on bank account deposits is taxed at a person's marginal rate once the interest earned exceeds their personal savings allowance. Secondly, with today's low interest rates, you are unlikely to achieve any real growth in a cash savings account.

Remember, just because you can access your pension fund, it doesn't necessarily mean that it is the right thing to do.

What kind of retirement income do people want?

Saving into a pension whether it is your own personal arrangement or an employer's scheme is merely a method of saving to accumulate wealth for your own retirement and the more you build up the better your lifestyle should be. However, how much you need will depend on a number of factors and will vary greatly from person to person. Over the last 18 months a number of providers have conducted research asking people how much they expect to live on in retirement and the results vary markedly.

Before pension freedom began, Fidelity Worldwide Investment reported that people believed they could manage on £11,232 per annum. Some months later, similar research conducted by Prudential reported that for those intending to retire in 2015, the desired retirement income was about £17,700 per annum, including State Pension. A more recent survey since pension freedom by Old Mutual Wealth and YouGov PLC reported that spending expectation had reached £19,700 per annum.

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Reality Check!

If you consider the maximum state pension of £8,094 p.a. (under new flat rate scheme for anyone reaching state pension age after April 2016), you can see that there is a significant gap between people's expectations and the income the state will provide, with a shortfall of £11,606 p.a. (£19,707 less £8,094 = £11,613). With life expectancy continuing to increase, the task of closing the gap will fall on the shoulders of the individual concerned. Any shortfall in income will need to be made up from private savings, investments and income from personal or workplace pensions.

If you are unsure of the potential value of your existing pension/s at retirement and whether they will be sufficient to provide the income you would like in retirement, you may wish to make use of our Pension Navigator service.

Pension Navigator is an objective analysis designed to assess how much income you will need in retirement and how much your existing pension plans, including occupational schemes and the state retirement pension, are likely to generate towards your target retirement income.

If there is likely to be a shortfall we will consider appropriate measures to bridge the gap and make suitable recommendations to help achieve your income goals.

We begin by helping you establish the income you are likely to need at retirement, including assumptions on the impact of inflation, and then ensure that your current arrangements are working as well as possible. If the existing schemes are working well we will tell you so, but if not, we will recommend a way to improve their performance. Equally we will highlight if you need to increase your current level of contributions to your pension provision.

We will also identify other saving and investment opportunities to supplement your retirement income and our recommendations will be based on our knowledge of you, your circumstances and attitude to risk.

Although you may feel retirement is some way off, time has a habit of running away with you and before you know it, your retirement date will be getting closer and you may not have sufficient time to make up any shortfall that looks likely.

(Source of all research/survey data: Unbiased).

Can you earn more money from your Cash Account?

Most people are aware that to realise a good return on their capital, they need to diversify into different asset classes to achieve their longer term financial goals. Part of this diversification will mean that some of your capital is held as cash. Typically, most people have their day-to-day money held in current accounts for simplicity, as you can pay your monthly bills easily and withdraw money for your day-to-day expenses. However, when we want to build up capital reserves for our 'rainy day' money it seems almost impossible to make any kind of profit with interest rates being at an 'all time' low. Clearly there are far fewer ways of earning a decent return. We are all looking for alternatives, and surprisingly, a current account could be the salvation for savers getting through the current climate, thanks to the generous rewards they can offer.

So how can this be achieved? By making use of the Current Account Switch Guarantee (which guarantees a successful switch within seven days or less and has been in force for three years this month), spenders and savers alike could earn up to £220 in the first year when moving their account.

According to Moneyfacts, research shows that the most rewarding current accounts can offer an equivalent interest rate of up to 11% (based on £2,000 cash saved in the first year), thereby giving the full £220 return. By contrast, the average easy access savings account would pay just 0.46%, which translates to a dismal earning of only £9.20 in the first year.

The table opposite indicates the kind of returns you could achieve with some of the top current accounts on the market.

It is worth checking out these accounts, as the cash rewards available means it could be a great time to take advantage, yet despite the Switch service (and the incentives), many people could still be missing out on a better deal, with it being estimated that just three million people have ditched their old account since 2013.

Rachel Springall, finance expert at Moneyfacts, sums it up: "Savers and spenders should definitely consider using a current account as a way of getting something a little extra, particularly with savings rates plummeting to record lows."

However, you need to be prepared and the most important rule in using current accounts to earn cash, is whether you meet eligibility criteria, which could be minimum funding requirements, or the need to bank online, or set up direct debits, so it is important to be aware of these before switching.

It isn't advisable to move to an account just for its perks; it must be a cost-effective choice and one that suits your needs. Bear in mind things like overdraft charges if you regularly dip into it, and be on the lookout for ways to save elsewhere (fee-free banking or a package of insurance products, for example).

"A decent current account can give customers so much more than just free cash," added Rachel. "With high interest rates on offer, exclusive products and even rewards on spending, there is an abundance of great incentives available. Borrowers can save cash too, with some accounts offering cost-effective overdrafts that could save frequent users hundreds of pounds.

"While it may seem an effort to compare current accounts, given the variety on offer, it is worthwhile to establish if any money can be saved, either in overdraft charges or by earning a little something extra each month."

Selection of providers with cash incentives	Type of reward gained (cashback on switching/ spending per month)	Cash earned in 1st year	Equivalent interest rate (based on £2,000)
M&S Bank Current Account	£100 (gift card) upfront + an additional £10pm (gift card, £120pa)	£220	11.00%
The Co-operative Bank Current Account	£150 upfront, up to £4pm + £1.50pm on debit card spending (£66pa)	£216	10.80%
HSBC Advance Account	£150 (switch) + £50 after 12 months	£200	10.00%
Halifax Reward Current Account	£100 (switch) + £5pm (£60pa)	£160	8.00%
First direct 1st Account	£100 (switch)	£100	5.00%
Barclays Bank Account	Blue Rewards £4pm (a) = £48pa	£48	2.40%

Accounts may require minimum funding or other requirements (e.g. online banking). (a) Cash received after monthly fee of £3 taken - more rewards available if certain Barclays products are held.

Source: Moneyfacts.co.uk Compiled 20/09/2016

Market Report

30 September 2016

Global Review

The world's central banks have continued to expand their stimulus measures in pursuit of stronger economic growth. Faced with the potential negative impact of the UK's decision to leave the European Union, the Bank of England cut interest rates and re-commenced its bond buying programme. In support, the US Federal Reserve held back from an expected hike in interest rates, whilst the Bank of Japan surprised markets with the announcement of policy designed to hold the 10-year bond yield at the current level of 0%.

After falling heavily on news of the vote to leave, equity markets quickly recovered lost ground and more as fears of recession were dismissed. Improving sentiment, political stability, central bank support and better than expected jobs and company earnings numbers have pushed markets close to record highs. Markets have also been buoyed by the UK government's intention to ease austerity measures and boost spending on infrastructure projects, a move that could be replicated across Europe.

UK

Firm belief that a vote to leave the European Union would send the UK economy into recession caused equities, particularly those of domestically orientated companies, to sell off heavily. However, forecasts by both the Bank of England and International Monetary Fund were soon considered too pessimistic as growth in the lead up to the referendum exceeded expectations and early indications post the vote suggested no signs of an economic shock. The rapid appointment of Theresa May as prime minister and firm action by the Bank of England saw a sharp bounce in equity markets back to pre-referendum levels.

In stark contrast to predictions of interest rate rises earlier this year, the Bank of England cut the cost of borrowing to 0.25% and committed further funds to quantitative easing in August. However, with the Bank ruling out negative rates and struggling to find sellers of government bonds, the governor called on the government to provide additional support for the economy. The new Chancellor subsequently scrapped the 2020 budget surplus target and promised more spending on housing and transport projects to boost growth.

US

Markets have been closely monitoring US Federal Reserve statements for direction on the timing of the next move in interest rates. Following the first hike from a historic low back in December 2015, the expectation was for at least two further rises in 2016 as the economy accelerated. However, the Fed have been reluctant to move citing a series of global risks that prevent a 'tightening' of policy despite the health of the US economy. With the US presidential election in November representing another such risk, consensus is expecting no further action on rates until December.

The Fed's current projection for future interest rates indicates two 0.25% hikes in 2017 followed by three more in both 2018 and 2019. This suggests another three years to reach 2.5%, well below the 3.5% by 2018 predicted just 12 months ago. By delaying interest rate hikes the Fed is retaining as much monetary policy influence as possible to fight future inflation. It will be the Federal Reserve's ability to control inflation rather than the ultimate level of interest rates that will drive financial markets.

Europe

There have been echoes of the Global Financial Crisis in Europe, centred on the Italian financial system, as the banking sector continues to struggle with negative yields. Italy has the third largest economy in the Eurozone and the country's banks hold an estimated €350 billion, equal to 21% of GDP, in non-performing loans. Current EU rules require bondholders to suffer the initial write-down of any bailout and given that 14% of Italian household wealth is held in bank bonds this could have a significant impact on the domestic economy.

The US Department of Justice has also imposed multi-billion dollar fines on a number of European banks for the mis-selling of mortgage-backed securities in the run-up to the Global Financial Crisis. Most notably, Deutsche Bank have been penalised US$14 billion. Whilst this is likely to be reduced, Germany's national champion has already failed US stress tests and has been identified by the IMF as representing "the most important net contributor to systemic risks". As a result, the bank's share price has fallen to a 30-year low and destroyed confidence in the sector.

Japan

With negative interest rates and stimulus measures worth in excess of ¥80 trillion a year already in place, markets were disappointed by the Bank of Japan's modest action in July. The lack of intervention by means of 'helicopter money', payments direct to individuals in an attempt to boost spending and ultimately inflation, put pressure on the government to deliver the 'bold' economic measures promised during recent electioneering. However, markets were again left disappointed with only ¥13.5 trillion of the ¥28 trillion promised coming from government coffers.

Having secured two-thirds of the seats in July's upper house parliamentary election, expectations were high that Prime Minister Abe's ruling coalition would be able to implement the next phase of Abenomics unchallenged. Expectation levels had already been inflated by weaker than expected economic growth in the second quarter. It was left to the Bank of Japan to restore confidence with a surprise move to cap 10-year bond yields at 0% and a pledge to overshoot the 2% inflation target.

Asia

Seven months on from the stock market lows in the first quarter, Chinese equities hit a new high in August boosted by the approval of the Shenzhen-Hong Kong Connect. The new trading link allows international investors to trade stocks listed in China's most important financial centre after Shanghai. Greater access to local markets is a key step in promoting Chinese shares to global equity indices with their likely inclusion further fuelling demand.

India introduced a new goods and services tax bill in August, heralded as the most significant reform since independence. New law consolidates all existing taxes and duties into a single tax, thereby removing bureaucracy and improving trade. It will also make the country more attractive to foreign investors. This adds huge potential to a $2 trillion economy already growing at 7%.

Active vs. passive investment

Passive investment can involve buying all the constituents of an index so as to replicate the performance of that index. Active investment involves managers actively selecting their favourite stocks or assets.

As passive management involves little skill it can be done cheaply. This has led to many suggesting that this is the most effective way to invest money. This argument is often supported by the supposition that few active managers consistently outperform the index. We take a more pragmatic view. We do believe passive investment has a place in portfolios and can often be an inexpensive way to get exposure to certain markets, however, we are firm believers that you do not want passive investment in all markets. There are some excellent active managers who consistently beat their benchmark, and believe we have a good track record in finding them. One problem with passive investment is that it guarantees underperformance relative to the index once fees are taken into account. By finding managers who regularly outperform the index, even by 1-2% annually, considerable outperformance can result. Over recent weeks, volatility in markets has increased and we expect this to continue for some time, creating marked swings on a daily basis. These large moves in stocks on a short-term basis are where active managers can score well. Good quality companies often see their shares fall with the overall market despite nothing changing in the outlook for their business. As fear grips the market and shares are sold indiscriminately, this can create excellent entry points for those prepared to look through the "short-term noise" and buy for the longer-term.

Another benefit of active management can be seen in less efficient markets. Smaller companies and emerging markets are not areas where we would use passive funds. Emerging markets encompass a wide range of countries and it is dangerous to class emerging markets as a homogenous region. An active manager can allocate to preferred countries whilst ignoring those deemed more challenged. Avoiding being in the wrong asset at the wrong time can be as important to returns as holding a 'winner'. Last year was a great example; active managers could significantly outperform simply by avoiding banks, oil and mining stocks, something trackers cannot do. Small caps tend not to receive the in-depth research and scrutiny afforded to larger companies and hence value can be uncovered by the canny and inquisitive researcher. This is why we use passive management in the US which is an extremely well analysed and efficient market where active managers can often struggle to add value. We are prepared to combine both passive and active investments where we feel it is appropriate but have faith in our ability to find managers who can regularly outperform their benchmark and believe we are entering an environment where stock selection is becoming ever more important.

For further information, please contact your adviser.

When managing investment portfolios for our clients we are relatively unrestricted in what funds we can utilise and so are free to access anything we feel appropriate. This means we have to consider the merits of using active or passive funds to deliver investment solutions for clients.

The over 50's continue taking holidays and remain undeterred by Brexit

The shock vote to leave the European Union does not appear to have dented the enthusiasm of the over 50's to travel, according to travel insurance company SAGA.

The firm revealed that a recent poll showed that 99% of its customers were sticking by holiday plans despite the vote to leave the EU on June 23rd. The firm's CEO Lance Batchelor said 'they are a tough bunch. They love to travel and if you talk to our customers as they approached retirement and asked them what they plan to spend their time on, the answer will very often be lots of travel'. He also added 'because they have at least 50 years of life experience, they are less likely to panic when things happen around the world. They want to carry on travelling, they are very brave and intrepid'.

However, recent attacks in Tunisia, Egypt, France and Turkey coupled with the hit on sterling from Brexit had dampened the demand to travel but many people have only changed their holiday destination rather than cancel their holiday plans altogether.

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