Birchwood Investment Management Ltd Newsletter

April 2022

It's plain sailing...

Happy New Tax Year...

April 6th heralded the start of the new tax year for 2022/23 bringing with it a brand new set of personal allowances and several tax changes, one of which is the widely reported increase in National Insurance contributions.

This new financial year is also synonymous with a tide of uncertainty as inflation now stands at its highest levels in over 30 years and with the fighting continuing to rage on in Ukraine, the cost of living is rising at an alarmingly sharp rate with fuel, food and energy prices all soaring. It's therefore even more imperative we use each and every avenue available to us to increase our savings and reduce the personal impact the current economy is wielding.

Understanding your allowances

ISA's continue to be one of the most tax efficient ways to save, and the earlier in the tax year you invest, the bigger your return could be once this tax year ends, thanks to compound interest and having more time to grow.

Investing in a stocks and shares ISA is never a guarantee that your money will increase, as investments can go up or down, but with an allowance of £20,000 this year, any profits you make are 100% yours with no tax payable unless you exceed that allowance.

Contributing to a personal pension also provides an element of tax relief of up to 100% of your UK earnings, or £3600 if this is greater (low income/non-earners) and the first 25% drawn down from your pension after the age of 55 (age 57 from 2028) is also tax free.

Don't wait for the "right" time

Living in times of uncertainty can make us hold onto any cash savings we have, which is not necessarily a bad thing. However if you're saving for the long-term, financial markets are naturally volatile and will go up and down depending on economic factors. Having enough cash for emergencies is absolutely sensible, however even after interest rates have risen, although we are seeing the knock-on effect on our mortgage rates, we are not yet seeing blanket rate rises within cash savings accounts so you are still likely to generate a better return through investing smartly.

Look at switching money from cash savings and diversifying your investments; committing to a monthly savings "drip-feed" will soon add up and may take a little fear away from transferring larger initial lump sums.

How comfortable are you with risk?

Investing should be viewed as a long-term proposition but our attitudes to risk change over time, depending on age, circumstances and goals. If things have changed it may be worth reviewing your portfolio with your adviser and the start of the new tax year is an ideal time to do this.

Be aware of capital gains tax

The capital gains tax allowance of £12,300 is now frozen until 2026; any profits made within the basic-rate tax band is taxed at 10%, or 20% at the higher/additional tax rate bands; residential property can sometimes fall within this secondary band. Subject to charges and related costs, it can occasionally be wise to sell investments not protected against tax and reinvest them into those that are, ie a pension or ISA, but do get independent advice before making these decisions.

In addition for those couples who are either married or in a civil partnership, assets can potentially be split as there is a joint capital gains tax allowance of £24,600 and gifts to spouses can also be exempt. There are various rules however that need to be considered and discussed with a qualified professional.

Review your financial wellbeing

Are your financial goals still in line with what makes you fulfilled in life? Money can be a great resource to help you live the life you want, not only incorpating tangible assets but also the ability to support family, philanthropic causes and build a level of financial security that will provide you with resilience in the future.

Don't get caught out by Inheritance Tax

The current nil-rate Inheritance Tax (IHT) threshold for a single person is still £325,000 (£650,000 for a married couple) and has remained at this amount since 2009. Often viewed as a stealth tax by the Government, if it had risen each year in line with inflation, by now it would have increased by £153,078 to £478,078.

Given that this figure has been frozen until 2026, a staggering 17 years without any increases, when you compare this with the UK's soaring house prices, more and more families who once would have never considered themselves to be affected, will now be adversely impacted as the value of their estates continue to rise. As a result they could face having to find over £60,000 to pay the HMRC, based on paying 40% tax on amounts that exceed the threshold.

The Treasury collected an impressive surplus of £700 million (or 14% increase) from IHT between April 2021 and February 2022, with £5.5 billion being collected in total. In a further blow, income tax and capital gains tax thresholds as well as the pensions lifetime allowance have also all been frozen until April 2026 at the earliest, whilst inflation currently stands at an overwhelming 7%. The additional nil-rate main residence threshold which allows parents or grandparents to hand direct descendants a further £175,000 from the family home has also been frozen for the same timeframe.

It is therefore unsurprising that the figure of £5.5 billion is forecasted to increase to £6.9 billion in 2023 unless we take action to protect our loved ones from this scenario. There are a number of steps that can be taken now, some of which are more beneficial the earlier they are implemented:

1) We can each give up to £3000 per year to family or friends without there being any tax liabilities on either side. This can rise to £11,000 if an allowance is carried over from a previous year and the person receiving the gift is getting married.

2) An amount over the IHT threshold could be donated to one or more charities of choice so there is a sense of satisfaction that your money is being used for philanthropic gains.

3) A property, cash or investments can be put into trust, which provided certain conditions are met, means that the ownership passes from the original owner and the assets' value is not counted towards IHT. A trustee is appointed who officially owns the assets, but it is their job to ensure the trust is run responsibly on behalf of the beneficiaries for when the time comes for them to benefit. There are several different trust options which is where a financial adviser will be able to provide you with the best route to take.

4) Give family assets at least seven years before you pass away. Whilst none of us own a crystal ball, we can make certain assumptions within our lifetimes meaning that if we live past the 7 year limit, no tax is payable by the recipient unless the gift is part of a trust. Any income or gains made by the recipient however, could be subject to for example, capital gains tax, so it is something that should be discussed in more detail to ensure it is the right option for your family.

Then of course the other option is to simply spend it and live well! At this stage we do not know if the IHT thresholds will rise after 2026 so it is worth staying mindful of all thresholds available to you and review these regularly.

What a difference a year makes

When it comes to our savings, a year is certainly making a huge difference as we emerge from all the pandemic restrictions to the world once again being rocked with the current situation between Russia and Ukraine.

For some, the country's lockdowns meant that through our day to day lives being curtailed, and some of the social and regular expenditure stopping, our savings pots per household grew by an average of £92 per week between April, May and June 2021. Fast forward a year, and with the cost of living and inflation soaring, this figure is predicted to slump to £26 a week or by 71% annually.

It's true to say that hospitality, leisure and personal care have all reopened and to all intents and purposes we are returning to a degree of normality.

This includes travelling and working back in physical offices with many of our daily expenses resuming, however household expenditure in general is expected to be 12% higher than this time last year, mainly due to rising taxes (National Insurance contributions) and soaring energy prices.

If we are hoping to achieve similar saving levels to 2021, we will need to be earning either an extra £80 a week, or spending £66 less per week as a household.

Whilst research has shown that we may see some improvements towards the end of the year, consumers are rightly concerned and have already been attempting to tackle these issues head on through making bulk purchases, cutting down on luxuries and buying own-brand items in a bid to save money.

Over half of us in the UK have turned to our savings in the last 6 months to help shore up our income, however this introduces further concern that emergency funds are depleting.

Whilst the here and now is critical, maintaining at least 6 months of rent/mortgage, bills and monthly expenditure is also important with Londoners requiring in the region of £31,500 to be accessible if needed.

We could see a surge in borrowing from the Bank of Mum & Dad in the next few months, but it's also essential for those in later life to weigh up their needs as well, especially if they have stopped working and are living on retirement income. 49% of first time buyer purchases in 2021 were supported through parents choosing to help their children step onto the property ladder and with interest rates climbing, they may also be tempted to help reduce or clear student loans.

Now, more than ever, open and honest communication is necessary as is seeking independent advice before making major decisions that could be more costly further down the line.

Market Report

April 2022

Global Review

The terrible events unfolding in Ukraine have naturally added to the negative sentiment that has dogged financial markets in recent months. Multi decade highs for inflation and downward revisions for economic growth have been exacerbated by the conflict. The prices of raw materials, energy and food were already rising as demand recovered from the covid lows, whilst pressures from ongoing supply chain issues have been extended by China's zero tolerance policy to coronavirus outbreaks.

Central Banks within the developed markets have begun to raise interest rates from the near zero emergency levels introduced more than a decade ago during the global financial crisis and bring to an end numerous quantitative easing programmes.

Policy is firmly aimed at bringing rampant inflation under control but comes at a time when household budgets are being squeezed by higher prices and companies are trying to manage the impact of higher input costs.

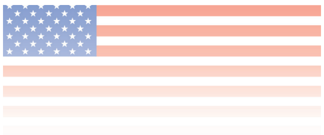
UK

As one of the first major central banks to raise interest rates, the Bank of England base rate now stands at 0.75% following quarter point hikes at both meetings of the Monetary Policy Committee so far in 2022. Financial markets were expecting UK rates to climb to around 2% by year end after inflation surged beyond levels not seen in 30 years but the events in Ukraine have prompted more dovish comments from the Committee.

Gross domestic product was stronger than expected in January, bringing economic activity back above pre-coronavirus levels whilst the unemployment rate fell to 3.9%, lower than pre-pandemic levels.

This better economic performance coupled with surging inflation has allowed the Bank to continue with a path of higher rates but there is clear concern that the conflict in Ukraine will have lasting impact on both growth and employment with inflation less of a concern in the medium term.

US



The US Federal Reserve waited until its March meeting before raising interest rates for the first time, having initially maintained the narrative that surging inflation was transitory.

However, February's inflation number of 7.9%, the highest in the US for forty years, marked the tenth consecutive print of 5% or more. Fed chair Jerome Powell was subsequently forced to concede that immediate action was required to combat the risk of an extended period of high inflation.

With the idea that policy was already behind the curve, there had been speculation that the Fed would hike rates by 0.50% particularly after confirmation that job creation and wage growth came in ahead of expectations in January.

Whilst the rate setting committee ultimately delivered a 0.25% hike, Powell later confirmed the option of more aggressive action at future meetings remained on the table. This pushed market expectations for rates to new levels and completed the Bank's pivot away from transitory inflation expectations.

Europe

The European Central Bank has also been accused of being behind the curve after stating in December that there would be no interest rate hikes before quantitative easing measures were fully wound down at the end of 2022.

However, following the invasion of Ukraine, the ECB announced an accelerated tapering of asset purchases with Bank President Christine Lagarde describing the conflict as a watershed for Europe. Initial estimates suggest inflation will hit 7.5% in March, reinforcing the need for the Bank to take earlier action on interest rates.

The ECB has been slow to react to inflationary pressures as they look to protect fragile economic growth in the face of lingering covid effects. Economic activity rose by 0.3% in the last quarter of 2021 but household consumption and trade were significant detractors as Omicron forced worldwide lockdowns. The Bank has downgraded its economic outlook modestly with the impact of the war in Ukraine mitigated by an improving labour market and easing of global supply chain issues.

Japan

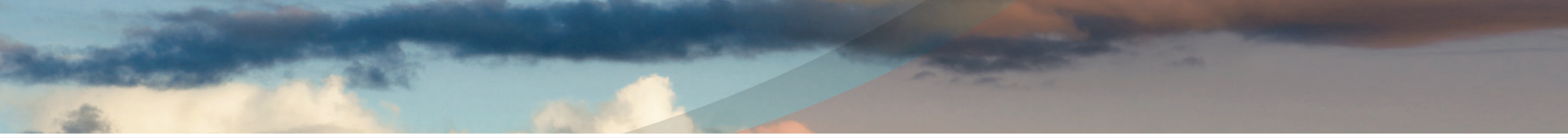
The Japanese government has also been more focused on the economic impact of the pandemic as coronavirus infections hit record highs in February. Parliament recently approved a record ¥108tn ($900bn) budget including a further contingency to combat stalling growth with the economy yet to recover to pre-covid-19 levels. The budget was well supported across the National Assembly and was quickly followed by calls for additional stimulus to support households facing rising food and energy prices.

Japan has struggled to avoid deflation for decades despite government efforts to stimulate consumption within a rapidly aging population. The recent budget allocated over one-third of total expenditure to social security payments. Inflation is likely to hit the Bank of Japan's 2% target this year but will driven by the impact of the Ukraine crisis and a weaker currency rather than domestic demand. Rising company input costs are also being passed on to the consumer, acting as a further squeeze on household budgets.

Asia

China also has ongoing coronavirus problems driven by the Omicron variant and has continued with a zero tolerance policy to the disease. Due to a spike in infections authorities have most recently imposed a complete quarantine of Shanghai, the country's largest city with 26 million residents, a major financial centre and the world's busiest shipping port. The effects will be felt across the global supply chain with the full economic impact yet to materialise.

The ruling Bharatiya Janata Party overcame accusations of mismanagement of the coronavirus pandemic to win four of the five recently held state elections in India, including that of the country's most populous state Uttar Pradesh. The overwhelming success of the BJP bodes well for the incumbent administration in the general elections in 2024. Almost two years after the country was subject to one of the world's most strict lockdowns, India finally registered less than 1,000 new daily infections this month.



Sustainable investing for the long-term

Many of us are now familiar with the terms sustainable and responsible investing and the anacronym ESG (environmental, social and governance) which is used to ascertain if a company/fund is operating responsibly.

The term "responsible" investing first began with ethical investing back in the late 1970s, with the first unit trust ethically screened in 1985; since then due to media interest and consumer focus on tackling climate change, fund managers and portfolios have taken a much longer term view on fulfilling clients' wishes to invest responsibly.

According to new research from the Wisdom Council, commissioned by Rathbones, 78% of people surveyed who are contributing to pensions believe they should play their part in environmental change. A larger piece of research by Allianz Global Investors showed that 83% of UK investors favour sustainability in general with 70% preferring to invest in funds that have a strong sustainability goal. Looking further afield, Schroders' 2019 "Global Investor Study" of 25,000 people illustrated 60% feel that their own financial choices will help support bigger changes overall in securing a longer-term sustainable future.

General consumer behaviour has also led to more critical exploration in companies' environmental testimonials with over £2.5bn added into sustainable funds alone in early 2021, even though these funds only make up 7% of total funds available.

Factors that govern whether funds fall under the ESG category include the more obvious ones such as a company's environmental impact, carbon emissions, supply chains and energy efficiency, however other considerations include:

* Data security and privacy
* How employees are treated
* Levels of wages paid
* Board structure including female representation
* Bribery and corruption
* Shareholder rights

It is important however to recognise that the UK has not yet passed any ESG regulations which means that fund managers could make sustainability claims that upon further investigation could and have proved a little controversial. Last year over 1,017 new sustainable funds came onto the market with a further 536 rebranded to be more ESG orientated so it's important that due diligence is carried out to ensure there are no connections to those firms operating in fossil fuels or with supply chains involved in somewhat questionable environmental activities.

Currently it is down to the investor to undertake research into how truly ethical ESG funds are, however with many of us not having the time or the technical knowledge in where to obtain this information, it's important to discuss your objectives with a professional adviser.

Integrating investments that target specific environmental and social objectives into your portfolio can be done through exploring your own personal interests and goals. For example some funds will pro-actively support social challenges such as reducing homelessness, whereas others will be targeting water scarcity and biodiversity where you may place more emphasis on achieving a desired outcome that is not necessarily solely a financial one.

Indeed the returns from ESG funds, which were once derided as lacking compared to the more traditional funds ie tobacco, arms etc have significantly increased and are often more resilient to external factors – something especially relevant given the economic events that continue to unfold.

It is also untrue to assume that sustainable funding is only a focus for the younger generations, as the research mentioned above has demonstrated. We are all harbouring a stronger sense of personal responsibility for not only protecting our planet for future generations to come, but also simultaneously caring about the people who inhabit it and quality of life overall.

Do you have enough to retire on?

According to new research from the Pensions and Lifetime Savings Association (PLSA) 26% of British workers with a workplace pension are worried they will not have enough income to retire on, especially in the current economic climate and rising bills.

With 29% of those aged between 35-54 feeling more anxious than those aged 55+ (20%), it is estimated that a single person will need at least £11000 a year as an absolute minimum to live on in retirement, £21,000 for a modest retirement and £34,000 to be comfortable.

For couples this changes to £17,000, £31,000 and £50,000 per year respectively. However separate research also commissioned recently has suggested we need to have saved at least £375,676 as a total pension pot for a reasonable standard of living in later life, although this is set somewhat on the conservative side and very dependent on the length of retirement.

We need to address the fact that we are generally living longer, and whilst we may wish to continue to work in roles we enjoy past the "official" retirement age, the Government are being strongly urged to level up pensions and over time increase the auto-enrolment contributions made by employers to match those of employees.

In the meantime it's important to regularly review forecasted pension savings to ensure they are in line with the life you envisage yourself having at the point when you decide to stop working.

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