

BIRCHWOOD

INVESTMENT

MANAGEMENT LTD

NEWSLETTER



July 2023

It's plain sailing...

The importance of preparing for a Comfortable Pension in your Retirement

According to a new survey from insurance firm Aviva*, 64% of those on middle incomes and due to retire in the 2050's, said that they have no idea how much they actually needed in their pension pot to ensure a comfortable retirement income. This in itself is concerning and follows the introduction of new pension savings rules in the Spring budget. The new pension changes that the Chancellor brought in on 6th April 2023 could not only affect your current tax year allowances but also have an impact on subsequent years to come. So, like so many others, if you are unsure where you stand on your pension and how the new changes could affect you, we are here to help.

The research also revealed that almost 3.4 million people in the 32-40 year old age range who are paying into their pension schemes could end up only accruing £225,000 or more by 2050 when they retire, which is unlikely to provide an adequate retirement income, especially as we are living longer. Additionally, half of this age group said that they have no idea how to plan for retirement and only one in ten of those on middle incomes have taken advice on planning for their financial future for when they retire.

This highlights a worrying future for millions of people and the challenges they face to manage their retirement planning. Aviva has published a new report 'Planning for retirement in the 2050s', alongside consultants WPI Economics, looking at the 32-40 year age group which found that just one in five are prepared for how

they will fund their retirement.

It also identified a big gap in the support people are receiving to prepare for their retirement and that they urgently need to take financial advice to aid their decision-making and planning. This is where the Government, regulators, and "industry" as a whole, need to work together to put that support in place for future retirees so they can make better decisions and achieve more positive retirement outcomes.

Under the new rules laid out in the spring budget, higher and additional rate taxpayers will be allowed to allocate more money to their pensions and will receive marginal tax relief. The extra annual allowance will also help people on all different levels of income to increase their pension pots. Here's a summary of what these new changes will mean:-

You can pay more into your pension

Under the new rules and if your earnings allow, most taxpayers can now contribute up to £60,000 a year, and you can receive tax relief for up to 100% of your annual earnings.

You can have a pension which exceeds or is close to £1,073,100

The removal of the lifetime allowance charge means that if you have a substantial fund, you can pay more into your pension and won't pay the tax charge if you go over the allowance threshold.

You can take money from your pension but

are able to continue or return to work

As the money purchase annual allowance (MPAA) has been increased from £4,000 to £10,000, it now means you are able to put more money into your pension tax free, which could significantly increase the value of your pension upon retirement.

You can benefit from employer contributions

You may have opted out of a workplace pension scheme and taken a cash alternative if you were previously close to breaching the lifetime allowance. With the new changes, it could now work out beneficial for you to start paying into a pension again and be able to take advantage of employer contributions.

You might be able to bring your retirement date forward

The removal of the lifetime allowance charge means you may now be able to bring your retirement date forward by saving more and giving your pension a boost.

You could take a tax-free lump sum from your pension

The maximum pension tax-free lump sum has now been frozen at £268,275 which is 25% of the current standard lifetime allowance.

You could have more flexibility with your lifetime allowance protection

If you already hold certain lifetime allowance protections, the amount of money you can take in a tax-free lump sum may now be higher, so it's beneficial to review these to see.....cont



Preparing for a Comfortable Pension cont.....

if you gain more flexibility as a result. However, the amount you are entitled to does also depend on the lifetime allowance protection that you hold.

You could pay less tax on an inherited pension

The pension changes on inherited pensions took effect on 6 April 2023 and are expected to be finalised within 7 months, once the Finance Bill passes through the Commons and Lords. By deferring the payment of the pension death benefits it could reduce the amount of tax you have to pay.

You could reduce the tax you pay on the Childcare hours scheme

When the new free childcare hours scheme comes into play, parents who have reached the £100,000 earnings threshold will be receive a large tax hike, but by increasing your pension payments, it could bring you back under the threshold.

You could have pension death benefits written into a trust

If you have a pension that has a designated trust written in to receive benefits on your death, this could result in an unnecessary tax charge

during the 2023/24 tax year.

With the rise in state pension age regularly being reviewed, it is imperative to have other options for funding the lifestyle that you desire and to live comfortably in your retirement. Taking regular financial advice is essential to explore how you could increase your savings and maximise your retirement pot.

Protect yourself from Costly Inheritance Tax Mistakes

According to the Office for Budget Responsibility, over the next 5 years, inheritance tax will impact between 38,000 and 47,000 families every year, who could be spared inheritance tax bills if the threshold was raised in line with inflation. With 50 MPs already calling for the so called 'death tax' to be abolished before the next general election and the Telegraph also launching a campaign to scrap inheritance tax what do you need to know and how can you protect yourself if you are not married or in a civil partnership.

Inheritance Tax which is one of the most hated schemes, is a tax on the estate (property, money and possessions) of someone who has died. Generally, there is no Inheritance Tax to pay if the value of your estate is below the £325,000 threshold or if you leave everything above the £325,000 threshold to your spouse, civil partner, a charity or a community club. The Inheritance Tax rate of 40% is charged on the part of your estate that's above this threshold and is payable to HM Revenue and Customs (HMRC) by the person dealing with the estate.

In the 2022/23 Tax year, this death duty raised a record £7.1bn, which was £1bn more than the previous year, meaning thousands of middle-income families were dragged into the frozen threshold of £325,000. If this threshold, which was set in 2009, was increased by the government in line with inflation, it would

currently be £483,812. This would stop thousands of families having to pay the 40% charge, which was originally meant as a levy for the "super-rich".

Other allowances that would substantially gain from being raised in line with inflation include gifting allowances (which could increase from £3,000 to £10,789) and small gift exemptions (£250 increasing to £1000) which would make an immense difference to families making gifts to family members in need.

The current inheritance tax rules for allowances and exemptions are now very out-dated and only apply to married couples and those in civil partnerships. They are not so clear when it comes to those in a modern cohabitating relationship. There are presently several exemptions that allow families to defer the tax payable when wealth passes directly down to their spouse or civil partner. However, those with 'non-traditional' family units could face difficult financial and personal decisions following the death of a loved one."

The Spouse Exemption allows married couples and civil partners to leave their entire estate to their partner when they die and for it to be completely tax free. Therefore, IHT is only payable at 40% above the £325,000 amount once the second person dies. On top of this

there is a £175,000 residence nil rate band (or £350,000 for a married couple) which can shelter the value of a residence. This extra allowance, when it's combined with the regular £325,000 (£650,000 for a married couple), means that overall you can benefit from a £1million IHT free allowance.

However, this exemption does not apply to those who are living as common-law partners or those who cohabit with a child or children from a previous relationship. They could find themselves without the right paperwork in place to receive the appropriate tax relief e.g. a Will. Therefore, they could be forced into selling assets in order to raise funds to pay the potential liability. Even if a cohabiting partner has acted as a parent for many years, unless they have formally adopted the child, only the legal parent's estate will be able to utilise all of the available allowances.

Inheritance Tax planning is a very complex and specialist area and a Will that is properly drafted and reviewed on a regular basis can help ensure assets are distributed correctly, especially if you are not married or in a civil partnership. It is always advisable to speak to a Financial Advisor to avoid any nasty shocks in the future and maximise IHT efficiency.



inheritance tax

Investment Insights

July 2023

Q2 2023 Overview

Table 1: Asset Class Performance Table (performance data for Q2 2023).

Asset Class	1 month	3 month	YTD	1 Year	3 Years (Ann)	5 Years (Ann)
UK Equity	1.40%	-0.31%	3.24%	9.15%	10.85%	-0.06%
Global Equity	3.19%	3.43%	8.11%	11.89%	10.46%	0.68%
DM Equity	3.42%	4.07%	9.22%	13.80%	11.65%	0.80%
EM Equity	1.28%	-1.74%	-0.56%	-2.36%	1.74%	-0.35%
Global Property	0.72%	-1.75%	-2.83%	-6.31%	5.37%	-0.35%
Global Bonds	-2.52%	-4.23%	-4.03%	-5.74%	-5.86%	-0.86%
UK Gilts	-0.48%	-5.96%	-3.84%	-15.47%	-12.16%	-1.22%
EM Bonds	-0.63%	-1.26%	-1.78%	2.07%	-3.60%	-0.25%
Oil	1.67%	-7.44%	-14.68%	-28.61%	28.24%	-1.53%
Gold	-4.69%	-5.20%	-0.29%	1.47%	0.16%	-1.06%
Commodities	1.43%	-5.24%	-12.75%	-13.66%	16.71%	-1.07%
IA Mixed Investment 40-85% Shares	0.32%	0.17%	2.43%	3.32%	4.03%	0.03%
IA Mixed Investment 20-60% Shares	0.06%	-0.38%	1.22%	1.15%	1.64%	-0.08%
IA Mixed Investment 0-35% Shares	-0.17%	-0.95%	0.68%	-0.71%	-0.85%	-0.19%

Source: Morningstar, 30th June 2023, Returns in GBP

June sees the end of the 2nd quarter and the midpoint of the year. Often a point at which to take stock of the year and evaluate what has transpired and where to from here. We have said before that month-end, quarter-end and year-end reports are just assessments at a specific point in time and there is no more or less significance to a quarter end than any other date in the calendar year as far as market specifics go.

The second quarter was less rewarding than the first quarter for multi-asset investors. This was primarily driven by poor performance in commodity, real estate, UK equity and fixed income markets.

Equity markets have continued to perform well. Except for the UK and emerging markets, the general trend for 2023 remains upward.

We will touch on some of the nuances around the YTD and quarterly performance within equity markets. The story of the second quarter can be simplified to a quarter where diversification worked against you and the more conservative the portfolio the weaker the quarter's performance.

One main talking point during the quarter was the expectation that interest rates would need to remain elevated for longer as inflation readings across the developed world remained higher than expected. This is despite further deterioration in economic fundamentals and a tightening in credit conditions. Alongside continued resilience in labour market data, this left central banks little choice but to continue hiking rates and increase their rate projections to levels which would make conditions sufficiently tight and bring inflation back into the targeted range.

This was especially pronounced in the UK where the headline inflation figures remained north of 8% year-on-year leaving the BoE little choice but to shock the markets with a sharper rate hike than anticipated late in the quarter. Gilts and UK corporate bonds were some of the poorest performing assets during the quarter on the back of these rate expectations shifting upward from already elevated levels.

Commodity markets remain under pressure as the Chinese economic rebound continues to fall short of expectations. China is one of the world's largest consumers of commodities, with the slower recovery post the relaxation of COVID restrictions translating into lower demand the commodity market has dipped further. Gold is somewhat disconnected from the Chinese and the general commodity consumption story, it has weakened this quarter from a combination of lower demand, a stronger dollar, general risk-on sentiment, and the fact that the metal does not generate a yield.

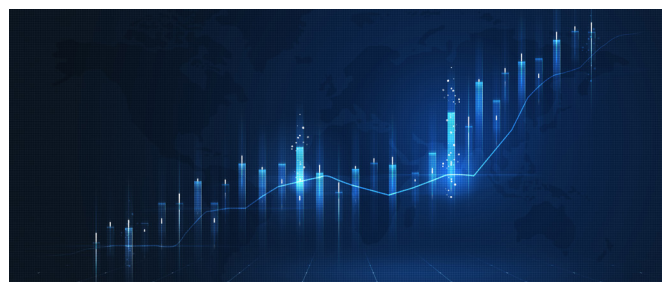
Year to date it has very much been a year of equity markets driving investor returns and specifically US and Japanese equities. Meaning investors with a home bias have underperformed their global counterparts.

Another driver of the UK equity underperformance during the year has been the strength of the Pound relative to the US Dollar. This may seem counterintuitive, but the significance of non-GBP revenues in the larger market capitalisation UK listed market has a negative effect on the earnings of those businesses. This GBP strength has been driven by global investors seeking out the attractive yields on offer in the UK, often referred to as the carry trade.

UK multi-asset portfolio investors had a better month of June with a positive equity market performance and some positive contribution from commodity and real estate markets but for the quarter the picture was more mixed with only the more equity orientated funds in the IA Mixed Investment peer groups generating a positive return over the quarter. Fixed income was a detractor and therefore negatively impacted more conservative portfolios.

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- 1 Year to date
- 2 Bank of England
- 3 Home Bias is the tendency for investors to overweight their portfolios with domestic assets, such as stocks, bonds, and real estate.



Can AI replace a Financial Adviser?

Whether you agree with it or not Artificial Intelligence (AI) is here to stay and is making leaps and bounds from when it first appeared in the 1950s. To many people, when you say 'AI' it makes them think of "Terminator" films or robots walking around serving customers, but there is another side of it and financial services is just one of the many areas that it can benefit. With millions saying they just can't afford to pay for professional financial advice, can an AI Personal Finance App really replace a Financial Advisor and more importantly can you trust it?

When it comes to AI, the advancements we have experienced in the last 20 years is equivalent to the previous 100 years and has been a motivating force behind our rapid technology advancement.* Functioning AI (or Artificial Narrow Intelligence as it is commonly referred to) has been in use for many years and focuses on performing specific tasks, which is why it works so well in financial services.

Artificial Narrow Intelligence (ANI) is already in place across many financial services and is used to help with areas such as:

- *Credit decisions (credit scoring, lending advice)
- *Risk management (fraud detection and prevention)
- *Investment management (AI coordinating trading decisions)
- *Process automation (AI-identified decisions implemented through RPA)
- *Chatbots (customer support, FAQ)
- *Virtual assistant (mortgage advisor, household budgeting)
- *Claims management (AI-enabled insurance damage assessments)
- *Dynamic pricing (AI-based insurance risk assessment)

Wally - a free personal finance app that allows

users to sync and manage their accounts and monitor their finances has just incorporated an artificial intelligence assistant to provide personalised advice to users.** WallyGPT means users will be able to ask questions about their finances, get help planning for the future, and be offered insights into investment opportunities and financial literacy. Although Wally has been operating since 2013 when the company was founded, it is hoped the new GPT function will help people make more informed financial decisions and therefore, change financial planning for the better. The new tech prepares data based on users' questions and then combines it with intelligence from OpenAI, which is an artificial intelligence research laboratory. However, it does raise questions about privacy and the overall role that financial planners will play in the age of AI.

There has always been a real divide between those that can afford to take financial advice and those that can't, so can AI fill this gap? Some financial providers have already tried to fill this gap with Robo Platforms that take you through a gamification process to determine how you should invest based on your risk attitude. Others sell packages that show you how to invest for your goals or offer a portfolio health check. Although this can never compare to speaking to someone in person, it is a start, so can AI take this to the next level?

ChatGPT that is used in the Wally personal finance app is a very powerful tool and the latest version (GPT-4) has even passed the bar exam for trainee lawyers with flying colours. If you use AI technology on a daily basis, on your phone or computer, you may already either be feeling the benefits, or you may be very concerned as to where the future is going. Either way, there are many things that you need to consider when using AI for financial decisions.

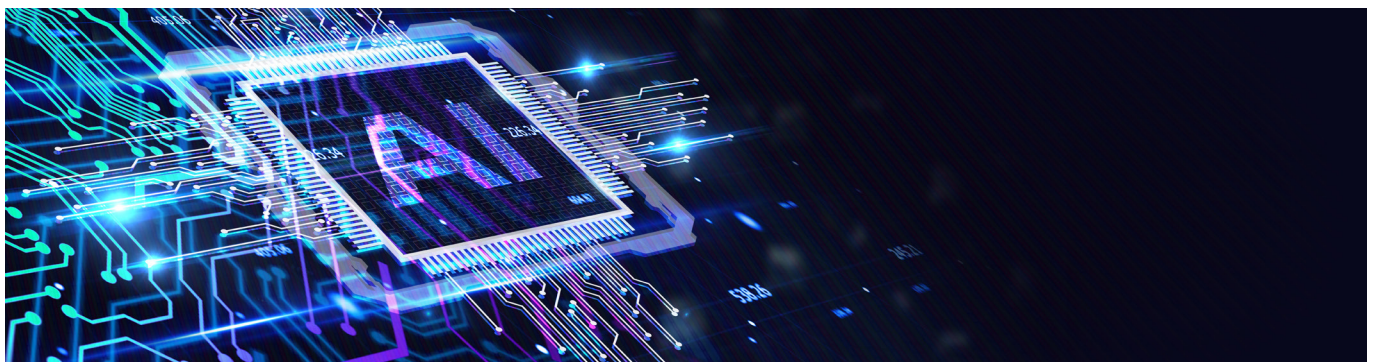
Sharing personal information - always be cautious of sharing personal information with a chatbot, as it could mean the advice you get is not right for you.

Your personal circumstances and feelings - AI won't know anything about your personal financial situation and definitely won't know how you're feeling. Although ChatGPT may be great at crunching numbers, it won't be able to delve into your individual needs or have that crucial human connection.

It won't know if something is the wrong decision - If you are thinking about retiring, the wrong decision could be an expensive mistake and make a big difference to your retirement pot.

You could get given old or out-of-date information - Financial advisors are constantly training and researching to ensure that the financial information they are giving is up-to-date. Whereas there is always the risk with AI that it has not been updated with the latest information.

ANI is here to stay and it's rapidly becoming a part of everyday life. It will continue to evolve, but firms always need to consider how AI will impact their individual businesses. If the fast rate of progression we have already seen is anything to go by, over the next few years it will provide many opportunities to enhance decision-making, automate everyday tasks and develop personalised financial products. However as it ends up evolving and improving, there's also a danger that it could make the financial advice gap grow wider and considering the current cost-of-living crisis we are in, could mean that less and less of the UK population will be able to access accurate and effective in-person financial advice.



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