BIRCHWOOD
INVESTMENT
MANAGEMENT LTD
NEWSLETTER

October 2024

It's plain sailing...

Why Millennials are Relying on their Parents to Fund their Retirement

Retirement is supposed to be a period in your life when you finish work and look forward to spending more time doing the things you love in life, including the opportunity to travel or indulge in activities you simply couldn't do whilst working full time. However, new research from wealth manager Moneyfarm, has found that nearly six million millennials are relying on their parents' wealth to fund their own retirement. From those surveyed between the ages of 28 and 43, four in ten said that they will not be able to retire without financial support from their parents - with more than half saying that cash from their parents will be their only source of retirement income.

For many retirees despite bringing their offspring up and providing a home and education for them during their younger years, they now have the added pressure of having to continue supporting their children's future retirement whilst trying to enjoy their own. Worryingly, as many as one in five millennials are relying on the money they will receive from an inheritance, with 4% having already planned exactly how they will spend the money!

In 2037, the state pension age is set to rise to sixty-eight, which is when the oldest millennials will be age 56. The minimum amount needed a year to cover your retirement currently stands at £14,400, but the Pension and Lifetime Savings Association (PLSA) has said that for a moderate retirement, £31,300 a year is needed, and for a comfortable retirement you would need around £43,100 a year.

As many as three in five millennials are struggling to save enough money for their retirement. Dealing with the financial hurdles they've faced in buying their own home, having children, and changing careers have all put extra pressure on their pension savings. Factor in the cost-of-living crisis, extremely high childcare costs and inflation, alongside a competitive housing market, it is no wonder that pension savings have not been high on their agenda.

Moneyfarm found that 30% of those surveyed do not think they will ever be financially secure enough to retire and finish work, with 29% saying they feel they will need to work in a part-time role past retirement age, and 16% feel they will have to continue working full-time.

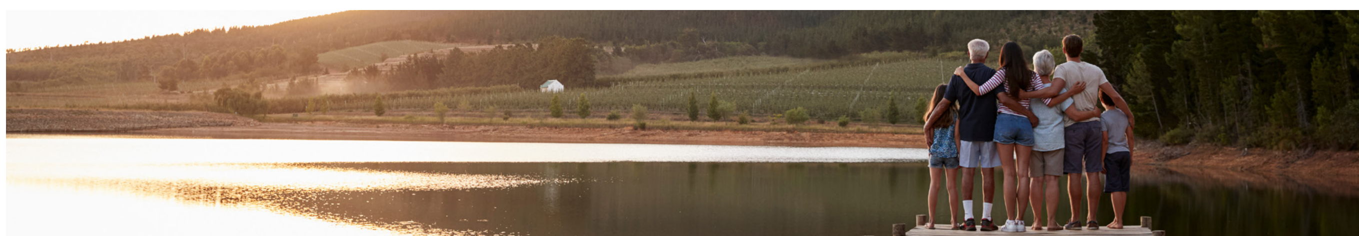
Will all these economic challenges the younger generations are living with more millennials than ever before are needing to turn to the Bank of Mum and Dad. Even on an average wage of £35,100, those wanting to buy a property need to borrow more than eight times their salary to afford the average home, which is currently valued at £290,000. Legal and General found that that as a result, more than 42% of properties bought this year were purchased with help from Mum and Dad, which is projected to reach £11.3bn by 2026.

Four in 10 (42%) also admit that even as an adult they still get 'pocket money' from their parents, with 18-29-year-olds most likely to get regular cash handouts and 17% of those aged between 30 and 44 receiving regular parental donations. Sadly, 46% admit that they feel embarrassed taking money from their parents, and 41% feel guilty, with 33% voicing their frustration in not being able to support themselves and their family.

Worryingly, there has also been a rise in the 'Club Sandwich' generation, which is where people are supporting three generations other than their own. Therefore, the recently retired could also be supporting their parents, children and grandchildren. Analysis from wealth manager St James's Place found that by 2029, 963,000 families will contain more than one retired generation, which is an increase of 18% from this year. The number is predicted to jump to more than 1,077,000 in a decade's time which is an increase of 32% from 2024 and equates to 264,000 families.

Whilst it cannot be dismissed that the baby boomer generation have benefitted from the astronomical increase in house prices, millennials need to do all they can to start preparing for their retirement - even saving modest sums will make a significant difference. But it's a fine balancing act against mounting living expenses and ever increasing housing costs.

The goal is to find a happy medium between millennials preparing for their later life, whilst still enabling their parents to enjoy their well deserved retirement and the money they have saved over the years. Birchwood Investment Management Limited can help you find the most effective way to balance the books of the Bank of Mum & Dad; please speak to your Financial Adviser for advice that tailored to you.



Choosing the Right Pension Scheme & Locating Old & Forgotten Pensions...

Choosing the right pension scheme for your individual retirement needs can appear overwhelming, but they're an essential planning tool to provide a solid financial safety net to give you security and peace of mind in later life. It's important to know the differences between the two main pension schemes available and keep track of all individual pension pots. According to Pension Provider PensionBee, almost 1 in 10 workers believe they have a lost pot worth £10,000 or more, with the overall amount of lost retirement money estimated to be around £50bn.

The majority of us will be enrolled in a defined contribution (DC) scheme, through an employer. It involves both you and your employer contributing into a pension and chooses fund managers with the aim of achieving a decent long-term return from the stock market to grow your money. However, if you work for a larger company, or within the public sector, you could be enrolled in a defined benefit (DB) scheme, which calculates your retirement income based on your average or final salary during your career. Here we look at the differences between the two and how they impact your retirement plannings:

Defined Contribution (DC) Pension Scheme – if you've started your own pension plan or your employer has enrolled you into their company scheme, it's likely to be a DC scheme. A DC scheme varies in what you can earn depending on how much you pay in and how it performs on the stock market. Employers and employees pay a minimum monthly amount, which currently stands at 8%, divided into 5% from the employee and 3% from the employer - but you can contribute more. These contributions earn pension tax relief from the Government, based on your marginal rate. An asset manager then builds a stock portfolio for you and invests it into the stock market, to hopefully yield a substantial pot for your retirement.

Defined Benefit (DB) Pension Scheme – If you work for the public sector or a larger company, the likelihood is you'll be enrolled into a DB plan. Instead of relying on contributions, it outlines a defined income that you will be paid when you retire. This income is either calculated on your final salary when you retire, when you leave the scheme, or it'll be based on your career average during the period in which you've belonged to the scheme. A DB plan is easier to predict but can be expensive for companies to manage, as they need to fund the schemes and then pay you an income at a set retirement age. It's for this reason many employers are now refusing to use this scheme or are offering a mix of both pension types.

What are the main differences between the schemes?

When weighing up the pros and cons, both schemes are "invested" and receive tax relief. With a DC scheme, both sides contribute, however the investment risk is entirely with the employee in terms of the final amount they receive; it depends on how much you contribute and how well this money is invested on your behalf. You don't get a "guaranteed" income when you retire, but you can choose to access your pension through drawdown (a way of accessing pension income when you retire whilst allowing the fund to keep growing) or by taking an annuity (this converts your savings into an annual pension, guaranteeing income for life).

When it comes to a DB scheme, the employee is guaranteed a definitive amount when they retire, which is based on either their final salary or a career average. The money in these pension funds is secured by the Pension Protection Fund, should the employer fail, which protects 90% of the expected pension payouts for current workers, and 100% for those already retired.

DB Pension Schemes ensure you receive a guaranteed income in retirement, which usually increases with inflation, but you can only start receiving payments from a set retirement age, usually 65 or the state pension age. Alternatively, with the DC scheme you can access your payments from the age of 55, which is rising to 57 from April 2028.

A DB scheme is also not as flexible, as you can't change how much money you withdraw, and there could be limits on how you take out any tax-free cash; whereas a DC plan usually allows you to vary withdrawals and have the option of drawdown or an annuity, alongside the 25% tax-free lump sum.

On the negative side, there's no guarantee on the amount of money you will receive when you retire as it depends how it fares on the stock market.

Therefore, there are pros and cons to both schemes - the DC scheme offers more control and flexibility but also comes with greater risk and uncertainty. Conversely, the DB scheme provides a guaranteed retirement income, but with less control and flexibility for the person concerned.

Do you have several pensions from different jobs?

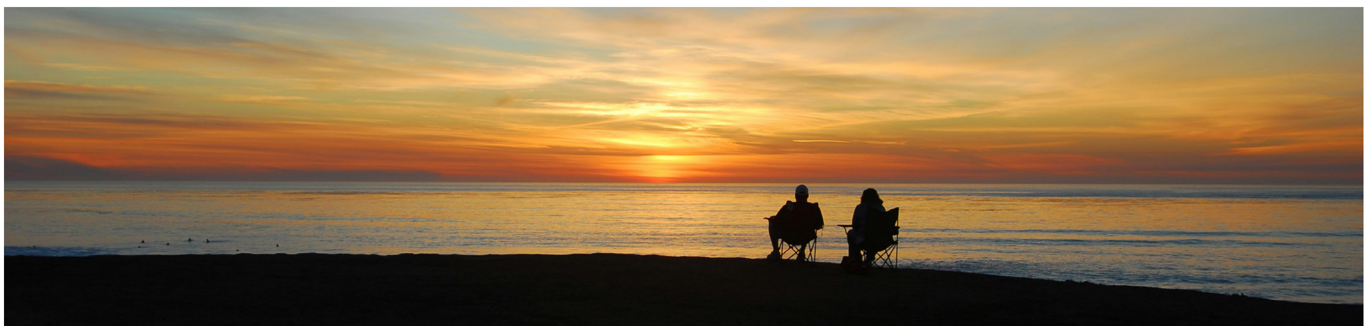
In the days of a 'job for life', keeping track of your pension was not an issue, but now people are changing jobs more frequently and are being enrolled into a new employer's workplace pension scheme each time they start a new job. Moving house can also be an issue, especially if you have lived in several locations as you may not remember to update your address with older pension providers.

According to research from PensionBee, the youngest employees are forecast to accrue, on average, five different pension pots by the time they reach the age of 68: with others potentially accumulating anything up to 20 separate pension pots over their working lives. Although tracking these old pensions down may appear overwhelming, you could be sitting on several smaller funds which could make a big difference to your lifestyle when you retire.

How can I track these old Pension Pots down?

There are several ways you can track down an old pension. The first and obvious method is to contact your old employer to find out which pension provider they used. If this is not possible, you can use the Government's Free Pension Tracing Service, where you can enter your basic personal details in along with your NI number to check it against more than 200,000 pension schemes.

If you need professional advice regarding your pensions, please get in touch with your financial adviser here at Birchwood Investment Management Ltd, who will be only too pleased to help.



Investment Insights

October 2024

Q3 2024 Overview

The third quarter saw a mildly positive performance for markets. Global equities delivered a total return of 0.6% for the quarter, this brings the year-to-date ("YTD") performance to 13.2%.

While there was broad equity market performance, there was a rotation out of the large growth tech names that have dominated headlines and led the current bull market. Corners of the market which have previously lagged, performed strongly. US Small Caps which were actually negative year to date going into the quarter delivered a return of 3.8% in the quarter. The US market saw a broadening out of performance, most easily shown through the S&P 500 Equal Weighted Index, which is the equal-weight version of the widely used S&P 500. The index includes the same constituents as the capitalization weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight - or 0.2% of the index total at each quarterly rebalance, which delivered a return of 3.3% compared to the market cap weighted S&P 500 performance of -0,2% for the quarter.

UK equities rose 1.7% in the quarter and the Pound strengthened 6.1% versus the Dollar. A Labour general election win at the start of the period fuelled hopes for a sustained recovery in the domestic economy. The optimistic market outlook was tempered by UK Prime Minister Keir Starmer's warning of a challenging autumn budget. He hinted at potential tax hikes and spending reductions to address a projected £22 billion gap in public finances, raising concerns about fiscal tightening in the months ahead.

Emerging markets outperformed Developed in the third quarter, with China being the largest contributor. South Africa was also a strong performer in the quarter delivering a 9.6% return. The smooth formation of the Government of National Unity and the Central bank cutting rates gave investors' confidence.

Chinese equities started the quarter fairly muted, but following the announcement of aggressive economic stimulus measures the Chinese market rallied. The CSI 300 Index, a benchmark for the Chinese stock market, gained around 25.0% over just five days at the end of September. Chinese equities returned 16.5% for the quarter, bringing the YTD performance to 23.2%.

The third quarter saw the start of the interest rate cutting cycle in many major economies. The shift in investor's expectations for interest rates helped fixed income to perform strongly in the quarter. US Government bonds returned 4.6%, while UK and European Government bonds increased 2.4% and 2.1%, respectively.

Commodities fell in the third quarter, primarily driven by a weak energy market. Despite increased tensions in the Middle East, global demand weakened due to growth concerns. Gold continues to perform strongly, with the metal increasing 6.7% in the third quarter, bringing the YTD return to 21.5%. Gold miners which are typically leveraged to the gold price had a strong quarter with a return of 12.7%.

Overall it has been a better quarter for our client portfolios as many of our overweight positions outperformed the dominant US equity market. Our asset allocation and style preference, of value over growth, contributed to performance for the quarter and while manager selection remained a slight detractor we remain optimistic going into the final quarter of the year.

In our recent portfolio reviews we have increased global equity while trimming global fixed income into strength. The increase in equity has been allocated where we believe valuations remain attractive on an absolute and relative basis. We cover our views on US small and mid-cap equity in detail below, which is one of the main areas where we have made increases within our equity allocation.

We have also reduced the allocation to gold miners after strong performance in the last 12 months and YTD, while we retain an allocation in the portfolios, we have reduced the position on strength and re-allocated this to broader commodities on weakness.

Table 1: Market performance

Total Return (GBP) (%)	Q3 2024	YTD
Global Equity	**0.6%**	**13.2%**
Developed Markets	0.3%	13.4%
Emerging Markets	2.6%	11.4%
Developing Markets ex. US	1.6%	8.0%
United States	-0.2%	15.6%
United Kingdom	1.7%	9.7%
South Africa	9.6%	16.0%
China	16.5%	23.2%
US Equity	**-0.2%**	**16.0%**
US Growth	-2.3%	21.8%
US Value	2.8%	9.6%
US Equal Weight	3.3%	9.4%
US Small Cap	3.8%	3.9%
Commodities	**-5.1%**	**0.6%**
Gold	6.7%	21.5%
Gold Miners	12.7%	27.6%
Global Bonds	4.2%	3.7%
US Gov Bond (Hdg)	4.6%	3.6%
UK Gilts	2.4%	-0.3%
EU Gov Bonds (Hdg)	2.1%	-2.1%

Source: Factset and Stonewood Wealth

US Small and Mid-caps

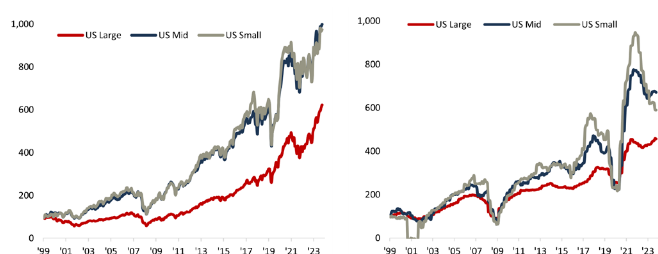
(All returns and graphs in the section are displayed in US Dollars)

Over the long term, US small and mid-cap stocks have historically outperformed their large-cap counterparts. Over the past 25 years, small-cap stocks have delivered an annualized return of 10.0%, while mid-caps have returned 10.3%. In contrast, large-cap stocks have provided an annual return of 8.2%. The outperformance of smaller companies can be attributed to their greater potential to grow revenues and profitability. However, this growth is typically more volatile as these companies are more sensitive to economic cycles and macroeconomic conditions.

In the past decade, this long-standing trend has reversed, with large caps outperforming. Notably, most of this outperformance has occurred in the last two years. Large-caps have outperformed small and mid-caps by 11.1% and 7.8%, respectively, during this period. While equity returns are driven by earnings growth over the long term, the recent divergence has largely been due to macroeconomic factors. As seen in Charts 1 and 2, the earnings of smaller companies have grown faster than large-caps over a longer horizon. However, in the last two years, small and mid-cap earnings have declined, as shown in Chart 4.

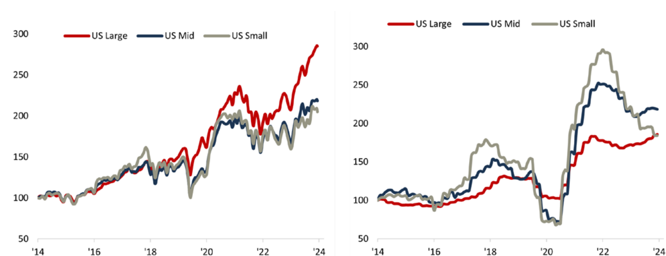
Investment Insights cont....

Chart 1: Price Performance & Chart 2: Earnings per Share



Source: Factset and Stonewood Wealth

Chart 3: Price Performance & Chart 4: Earnings per Share

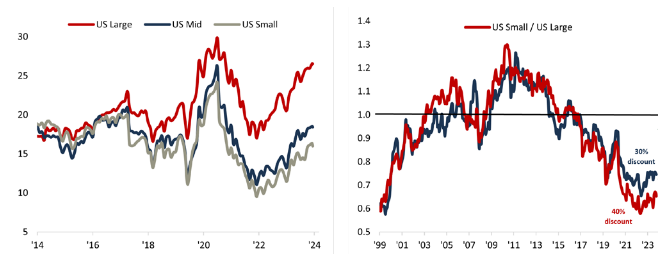


Source: Factset and Stonewood Wealth

This recent underperformance stems from the smaller companies' sensitivity to economic conditions, particularly rising interest rates. The rapid inflation and subsequent Federal Reserve rate hikes have increased borrowing costs, which has created significant headwinds for smaller companies' earnings. Larger companies, being more resilient, were better positioned to weather these challenges, managing to generate flat earnings during the same period.

Following the difference in performance between large and smaller companies there has been an increase in large-cap valuation multiples while small and mid-cap multiples have only increased to around their average levels. Chart 6 shows the divergence in valuation between small and mid-caps. Chart 7 shows the relative discount of small and mid-caps to large-caps. Small and mid-caps are currently trading at 40% and 30% discounts to large-caps, respectively.

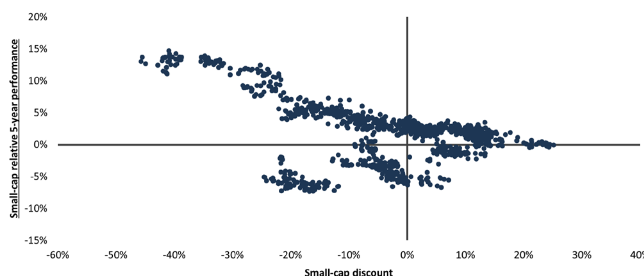
Chart 6: Price to Earnings & Chart 7: Relative Price to Earnings



Source: Factset and Stonewood Wealth

Historical data, as illustrated in Chart 8, shows that when small-cap stocks have traded at a significant discount (around 40%) to large-caps, they have typically outperformed large-caps by 10-15% per year over the following five years. This relative outperformance does not necessarily imply strong absolute returns but suggests that small-caps may outperform in a broad market drawdown. For example, large-caps could fall 10-15%, while small-caps might remain flat.

Chart 8: Small-Cap Discount and 5-Year Forward Returns



Source: Factset and Stonewood Wealth

In summary, the current environment of declining interest rates, coupled with a relatively strong consumer and a robust job market, should support an improvement in earnings for smaller companies. The significant discount at which small and mid-cap stocks are trading compared to large-caps also presents an attractive entry point for long-term investors.

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