What to do in 2016

Expectations for 2016 are modest compared to previous years. The harsh realities of 2015 are likely to continue in 2016. The major themes of 2015 were:

- Political pressure on the economy, e.g. the impact of Nene-gate on the Rand exchange rate;
- Budget pressure on the fiscus / increased taxes e.g. #feesmustfall;
- Sufficient electricity to encourage and maintain growth, e.g. load shedding (rolling blackouts);
- Slower Chinese economic growth and share price volatility (major buyer of our commodities); and falling oil and commodity prices (e.g. iron ore, platinum etc.).

The themes of 2015 are likely to continue into 2016. In addition, further important themes are likely to emerge. These include:

- Expectations of low domestic economic growth (less than 1% above inflation);
- Possible downgrades by global rating agencies;
- Rising inflation; and
- Municipal elections.

Without analysing each of these issues in depth, we believe that South Africa faces many challenges in the next year, which are likely to affect the investment returns of our retirement savings in a significant way. For young investors it is imperative to realise that the wheel will keep turning and that these challenges will invariably not last forever.

Globally the US economy is likely to continue growing, but more modestly than in the past. The big issues in the US are increasing interest rates, the strong US Dollar and the presidential elections in November 2016. Rising interest rates are likely to translate into investment returns from shares that are more modest as the cost of capital increases. Simultaneously, higher interest rates will support a strong US Dollar, which makes imports into the US more competitive.

Chinese growth is likely to slow, perhaps more than anticipated. The Chinese government expects economic growth for the next five years at below 7% per year. The swing away from the manufacturing sector to services continues. The impact of the re-alignment within the Chinese economy is perhaps that economic growth in China should not be expected to re-ignite world growth in the short-term.

As a result, the background against which we assess our expectations for 2016 are positive, but more modest than before.

The outlook for each of the themes in 2016 are:

- We expect **domestic economic growth to be lower than in 2015** because of continued electricity constraints, continued downswing of the world commodity cycle, policy constraints and other factors.
- The **price of oil is expected to remain under pressure** in 2016 as Iranian supply comes back on stream, some recovery may be possible towards year-end.

- Global rating agencies are likely to deal harshly with South Africa in 2016 increasing the **risk of capital outflows from South Africa**.
- **Inflation is likely to increase** in 2016:
  - o imported inflation because of Rand weakness;
  - o rising food prices as the drought affects local food supply;
  - o pressure on wage increases.
- Social issues such as #feesmustfall will continue and entice politicians to make **promises that are not easily affordable.**
- **Water supply constraints** may also lead to difficulty in 2016.
- Political events surrounding the **2016 municipal elections** are likely to affect markets negatively as pronouncements that are not "market friendly" may be forthcoming in the battle for votes.
- **Continued weakness of the exchange rate of the Rand** may affect investment returns. Rand weakness experienced through to mid-2015 could possibly have been attributed to US Dollar strength, but events late in 2015 showed just how vulnerable the Rand and South Africa are.

What to expect from investments in 2016?

• The **pressure on the Rand is expected to continue.** The cornerstone of any investment strategy for 2016 should be full exposure to non-Rand and Rand-hedge investments.

• Therefore, **full exposure to global investments** with emphasis on share investments will likely benefit investors. While we do not see another 35% drop in the value of the Rand as in 2015, we believe the likelihood of the Rand remaining weaker is significant.

• With the Rand under pressure and interest rates in the US and other countries increasing, it is likely that **interest rates in South Africa will increase** more sharply than in 2015. This will improve the investment return in the money market, but lower returns from bonds.

• As a result, we are also **weary of returns of listed property** where record returns have been experienced over the last five years.

• Local shares that earn income from foreign sources may perform adequately, as the impact of the weaker Rand in 2015 will affect financial results in 2016. This means that **non-resource Rand hedge shares are likely to lead the market** rather than shares that depend on the income from South African operations only.

• Even though arguments are being made that commodity stockpiles have been reduced to critical levels around the world (e.g. platinum), **we do not see a sharp upturn in commodity prices** over the short-term as low growth in commodity consuming regions prevail.

What to do in 2016?

• **Stick to a long-term plan** - it is important to define a long-term investment strategy for one's retirement investments and to stick to the strategy.

• **Avoid market timing** - it is difficult to time the market continuously and our approach reflect our prudent nature.

• **Go for quality** - the investment managers that are likely to be more successful than their peers in 2016 are managers that adhere to a quality strategy. These investment managers often underperform their peers in an upswing, but do much better in downturns or during prolonged uncertainty.

Finally, we believe that the outlook for 2017 will be much better than what is likely to occur in 2016. It is important to follow a multi-year investment strategy rather than plan for a single year only. One should therefore negotiate the challenges of 2016 to reap benefits in 2017!

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