Eroding expendable income

WALTER VAN DER MERWE,
CEO of FedGroup Life

There will be a number of key factors at play in 2016 that will affect the financial and insurance industries at large.

In line with general market expectations, we predict that inflation will increase at a consistent rate throughout 2016, eventually breaching the South African Reserve Bank's 3-6 percent inflation target.

This inflationary environment is due to a number of factors – the relative strength of the dollar, weak economic fundamentals in South Africa that are driving down the value of the rand, and a general move by investors away from riskier emerging markets and into more stable environments driven mainly by a rise in interest rates in the United States.

The consequences of higher inflation will be manifold. This essentially means that life will cost more for South Africans in 2016, further eroding expendable income and reducing the buying power of every rand they earn.

Interest rates will continue on their upward trend, having already experienced two increases of 25 basis points each in the last half of 2015. It will therefore cost more to service any form of debt, which will further erode expendable income. We therefore expect to see a dip in savings and, potentially, a thinning out of long term insurance business during the year.

"LIFE WILL COST MORE FOR SOUTH AFRICANS IN 2016"

Those who do manage to maintain their savings and investment contributions should also expect market volatility to continue. We find ourselves in somewhat of a dichotomous situation, as higher interest rates will offer better returns from various investment and asset classes. However, we're also in unchartered waters from a global perspective, where politically driven events and extreme adverse weather conditions are fuelling global market instability.

Without the ability to predict what may happen next in terms of ongoing terror attacks and other politically-motivated events, which are predicted to continue into 2016, and a lack of understanding in terms of the full extent and impact that global warming and the prevailing El Nino phenomenon will have on global weather patterns, expect that market uncertainty and volatility will remain throughout 2016.

We will certainly see more spikes and dips throughout 2016, but these are short-term occurrences. Investors should not panic nor should they react to every shift in the market. Stay calm. Rather take a long-term view and remain invested over a five to ten year period.

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POSITIVES

Despite the negatives, there will still be good investment opportunities in 2016. Not only will interest-bearing investments deliver a higher yield, but there are a number of sectors within the local economy that are still robust and have the potential for growth, despite the economic challenges. Take manufacturing for instance. It has already surpassed the previous darlings of the South African economy, industrials and resources, to become the country's biggest economic driver. And with sustained weakness in the rand we can expect to see a further uptick in manufacturing activity for export in the country over the next 12 months.

Accordingly, investors who stick with equity investments in businesses, that have strong fundamentals in place and don't speculate in this volatile and uncertain economy, can expect to outperform the average. Similarly, institutional investors that continue to take a conservative approach and invest where capital is secure will continue to earn robust returns for clients.

For those who aren't actively investing in the market, focus on paying down debt. Those who received bonuses at the end of 2015 should use some of that money to pay down their debts, reducing those that attract the highest interest rates first, such as credit card debt or unsecured loans, rather than spending it all during the traditional festive season splurge which is when retailers tend to make 80 percent of their revenue.

This will help to take out a bit of the sting and impact of rising interest rates in 2016.

Challenges and opportunities

CRAIG SHER,
Head of Research and Product Development at Discovery Invest

With economic and regulatory pressures as the backdrop to the insurance industry, Discovery Invest sees the following four trends emerging in 2016 to impact the market both as challenges and opportunities.

INNOVATION IS THE KEY

The pressure on the industry demands that investment providers focus their thinking not only on dealing with the challenges that directly emerge, but also on innovating to make significant step changes to the investment industry and the clients we serve. Offering products that take an innovative approach to savings clearly emerges as a prominent trend that will define 2016 for Discovery Invest.

Innovation will be central for solving our structural challenges going forward. For Discovery Invest, we've seen that the power of innovation has the ability to create a step change for the industry and hence we are already focused on offering and enhancing innovative investment solutions that holistically address retirement challenges, leading to better outcomes. We believe that strong innovation is one of the only mechanisms to address challenges outlined here.

POOR SAVINGS CULTURE COMBINED WITH INCREASED LIFE EXPECTANCY

South Africans have a poor culture of savings, with less than 6% who can afford to retire. Some of those who save do not have enough to retire. This is exacerbated by longevity, where people live longer due to improvements in healthcare. This would result in them outliving their savings as they get older.

MACRO ISSUES AND AN INDUSTRY INFLUX

The economy, weakness of the rand and a changing regulatory environment are projected to continue to exert pressure on the industry. Treating Customers Fairly, the Retail Distribution Review and the strong focus on various