Allianz Global Investors

Doing the right thing...

AND KEEPING THE MERCHANTS TRUST PORTFOLIO ON TRACK

So just how do we clean up the air? And can this be achieved without detriment to financial performance? In July, the UK Government announced its intention to ban diesel and petrol cars and vans from 2040, in a bid to tackle air pollution. This prompted a mixed reaction, with environmentalists and some politicians claiming more urgent action was needed while motoring experts warned that there would be unprecedented strain on the national grid and that electric cars would be less practical and more expensive. Concern was also voiced for the automobile industry which supports more than 800,000 UK jobs. So, a mixed response with various factors at play.

Although the global shift towards electric vehicles will create upheaval, it is inevitable. With environmental concerns outweighing concerns for industry there is now real momentum behind it worldwide. For example, Volvo has announced that it will produce only hybrid and electric cars from 2019, while BMW's electric version of the iconic Mini is to be built at its Cowley plant in Oxford.

We are living through a period characterised by change. This change looms in the shape of global socio-economic and environmental challenges that demand urgent attention, as evidence mounts on the need to tackle climate change, pollution and human rights, to name just three critical issues. There is mounting public concern that sustainability and ethical practices must be at the heart of infrastructure and other developments.

The scale of the challenges facing the planet is daunting. Weather patterns have created havoc around the world, not to mention worsening air pollution, deforestation, species decline and ocean degradation. But corporate culture is beginning to understand that it will be judged on its ability to adopt responsible and sustainable practices.

Businesses are now likely to face greater scrutiny to ensure that they are doing the right thing, as far as Environmental, Social and Governance (ESG) factors are concerned. Historically, ESG investing has been something of a niche, with the common assumption that limiting investments to those businesses with a strong ESG culture could be detrimental to investment performance. However, ESG is now something of a 'buzz' word and investors are increasingly looking to invest in companies with pro-ESG credentials.

As Portfolio Manager of **The Merchants Trust**, I and my team take an active approach to keeping the portfolio on track. We are very aware that our investors are looking to achieve above-average levels of income and long-term capital growth. Indeed, Merchants has delivered a rising dividend to its shareholders for 35 consecutive years. But we know that investors are also becoming increasingly interested in a company's attitude towards sustainability and the ethical impact of its operations.

Our universe is primarily large companies – well financed, global businesses that have strong franchises and the potential to deliver good income yields. We manage the Merchants portfolio on a high conviction, bottom-up basis, meaning that we look to select a reasonably concentrated portfolio of what we think are the best stocks irrespective of sector allocation. However, we are active stewards of the assets we own and we think it's also important to understand ESG issues when choosing stocks.

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The Merchants portfolio comprises circa 45 stocks and these companies typically adopt a detailed ESG policy as part of their non-financial objectives. They do this to be responsible investors, of course, but integrating ESG also brings business benefits. In some minds, ESG has become shorthand for identifying companies with superior business models that are focused on long-term success.

Marks & Spencer is one of Merchants' investments and it operates a sustainability plan it calls 'Plan A'. M&S research shows that its customers do care about the future of the environment but that they feel overwhelmed by the scale of these issues. So, they are putting their trust in big businesses, governments and other international organisations to tackle them on their behalf. As such, trust becomes a vital component between business and client – in the words of M&S, "Companies need to offer society a clear, measurable social dividend to earn and retain people's trust".

Businesses are placing more and more emphasis on ensuring that they have a positive economic, social and environmental impact on the community. Environmental infrastructure group **Pennon Group**, another of our investments, owns South West Water as well as a UK recycling, energy recovery and waste management company. Delivery of sustainability targets forms part of the remuneration package of Pennon's senior executives and employees.

We also invest in global resources company **BHP Billiton**, whose business is the discovery, acquisition, development and marketing of natural resources. Businesses such as BHP are naturally under close scrutiny vis-à-vis their ESG credentials but can do much to minimise their environmental footprint through innovation, productivity and technology.

Firms are doing more than ever before to ensure that they have a positive impact on communities, wellbeing and the environment. They understand that the global economy needs to be efficient in its use of energy and resources. But they are also acting because it makes sound business sense.

At The Merchants Trust, we recognise that ESG factors can add value to the stocks that we own. We are mindful of growing consumer concern towards these issues and that is why we undertake global analysis and research that underpins our overall investment approach. Our ESG research can help us identify companies with superior business models which can, in turn, add value for our investors. On that basis, we do believe that financial returns and the opportunity to better the wider social environment can sit side by side. Above all, we remain committed to being a responsible investment manager that offers Merchants investors a high conviction portfolio that can deliver outperformance over the long term. ■

This is no recommendation or solicitation to buy or sell any particular security. Any security mentioned above will not necessarily be comprised in the portfolio by the time this document is disclosed or at any other subsequent date. Investing involves risk. The value of an investment and the income from it may fall as well as rise and investors may not get back the full amount invested. The views and opinions expressed herein, which are subject to change without notice, are those of the issuer and/or its affiliated companies at the time of publication. The data used is derived from various sources, and assumed to be correct and reliable, but it has not been independently verified; its accuracy or completeness is not guaranteed and no liability is assumed for any direct or consequential losses arising from its use, unless caused by gross negligence or wilful misconduct. The conditions of any underlying offer or contract that may have been or will be made or concluded shall prevail.

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Simon Gergel is CIO of UK Equities at Allianz Global Investors and is portfolio manager of The Merchants Trust PLC. Merchants has for many years focused on a simple proposition to deliver a high and rising income together with capital growth for its shareholders. Although past performance is no guide to the future, Merchants has paid a rising dividend to shareholders for 35 consecutive years.