Where does the WORLD GO FROM HERE?

As we move from winter to spring, the political turmoil of 2016 still casts its shadow: the future repercussions of last year's Brexit referendum result and Donald Trump's election as President of the United States will surely shape politics for many years to come, although no one really knows how. Such unpredictability adds a new dimension to an already uncertain world. Both in the UK and the US, personality rather than policy seems to be dominating politics lately; and distrust in governments and politicians forms a universal theme. Globalisation now looks to be under threat, replaced by a tide of rising protectionism.

This creates an interesting – and challenging – backdrop for the year ahead, a new way of thinking that began last year with Trump and Brexit and will surely continue throughout 2017. This is a year in which there will be four important elections in Europe, including France and Germany, not to mention the reality of what the Trump presidency and the roll-out of Brexit will truly mean.

We are witnessing massive shifts in political trends. So, where does the world go from here and what may the implications be for investors? With a lack of certainty combined with the buoyant stock markets we have witnessed in the early part of 2017, one can't help but sympathise with investors who may feel daunted by the investment decisions they often make at this time of year, as one tax year ends and a new one begins. After all, this is traditionally the time of year when retail investors are most likely to invest in the stock market, using up their ISA or pension personal allowance before the tax year ends.

Hard to speculate how the stock market may behave

With the FTSE 100 reaching record highs in January (boosted by the fall in sterling which, in turn, benefited companies and funds with overseas exposure) it is very hard to speculate how the stock market may behave in 2017. It is possible to imagine a stronger stock market, caused by hopes for higher economic and profits growth, as inflation creeps back into the system. However, it is equally possible to make the opposite case, since rising interest rates could choke off economic growth.

Although the outlook may be difficult to predict, it is still possible to build a portfolio for these circumstances, finding investments that should deliver reasonable returns to investors over the medium term. As manager of The Merchants Trust, the team and I pay particular attention to the fundamental qualities and valuations of companies we invest in. We are looking to own strong businesses that are priced at attractive valuations, from which our investors can expect to earn a decent return over the medium to long term. An attractive valuation is particularly important, as it can provide downside protection in a difficult stock market environment, such as the current one.

Our fundamental approach to investing is designed to manage risk whilst delivering the upside for our investors, whatever the political landscape. We spend a significant amount of time understanding the business, financial and valuation risks of the investments we make. We believe this focus allows us to identify situations where the risk-reward profile in absolute terms is highly attractive.

Consistent to its roots

Launched in 1889, Merchants has been consistent to its roots ever since: the founders of the trust set out to deliver 5% income to investors and that is very similar to what we are striving to do in the present day. At the time of writing, investors in Merchants have benefited from 34 years of consecutive growth in dividend payments. Although past performance is no indicator of what lies ahead for capital and dividend growth, we hope investors will be reassured by the Trust's longevity and track record; after all, it has survived every conflict and crisis over its 128 years – and generated notable investment returns.

Attention to detail, diligent research, caution and the prudent accumulation of reserves have all been at the heart of Merchants from its first day, and all of these factors have played their part in its fulfilment of its investment aims: **to provide a high and growing level of income and long-term capital growth**. It sets out to do this by investing in between 40 and 50 higher yielding, large UK companies at any one time. This is a relatively concentrated portfolio but one that is driven by conviction, allowing a sharper and more detailed focus on each investment considered.

When it comes to stock selection, we are seeking situations where our assessment of the investment case is markedly superior to that which is discounted by the stock market. We use a fundamentally driven, bottom up investment approach, which we are confident will work out over the long-term.

Close attention paid to the risks in each stock

When constructing the portfolio, we pay close attention to the risks in each stock, including: operational risk, concerned with the business dynamics; financial risk, regarding the level of debt and strength of cash flow; and valuation risk, reflecting whether the shares could be vulnerable to a de-rating. Ultimately, we aim to have smaller positions in riskier stocks and the largest investments in the less risky stocks.

Within the portfolio, some of our biggest investments are in certain of the very largest UK companies, such as the oil majors, BP and Shell, HSBC bank and the pharmaceutical, vaccines and consumer business GlaxoSmithKline. There is a tremendous advantage in having these leading companies, which have substantial overseas exposure and earnings, listed in the UK stock market. This means that investors can benefit from extremely high standards of corporate governance and yet gain global exposure. ■

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 34 consecutive years.