

Investment Rationale

Investing in large UK companies, The Merchants Trust PLC aims to provide an above average level of income which increases over time. The Trust is managed by Simon Gergel, a Director at RCM with 23 years' investment experience.

Aim

The Trust's objective is to provide an above average level of income, income growth and long-term growth of capital through a policy of investing mainly in higher yielding UK FTSE 100 companies.

History

The Trust was incorporated in February 1889, making it the oldest of the investment trusts in the RCM stable. Initially it invested in the fixed interest securities of railway companies in the USA, Canada and South America, with the remainder held in Government securities and companies such as Castlemaine Brewery in Western Australia. The Trust now concentrates primarily on major UK companies with an above average rate of dividend yield.

Fund Manager's Review

Simon Gergel



October witnessed a sharp recovery in equity markets from the depressed levels of September. Hopes of some progress on resolution of the Euro crisis at the EU Summit on 27th October and marginally better economic news out of America boosted the market. This recovery was exacerbated by short term investors repositioning portfolios back towards a more bullish stance.

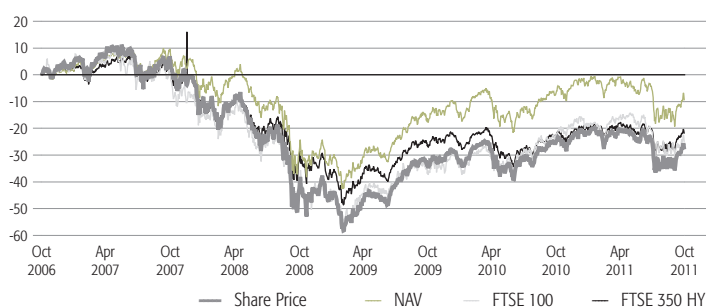
The FTSE 100 Index rose 8.11%, recovering most of the losses earlier in the year, whilst US and German equities produced double digit returns. There were also double digit gains in the price of oil and copper. Conversely US government bonds, seen as the "risk free" asset, sold off heavily with the 10 year yield rising from 1.9% to 2.2%. The UK equity market was led by cyclical sectors like mining, engineering and leisure goods which all produced mid-teens returns, whilst utilities, food producers and several other "defensive" sectors only managed low single digit gains.

The Trust returned 8.37% (capital only) outperforming its benchmark. The defensive nature of the equity portfolio meant that performance trailed the strong market return, before the beneficial impact of gearing. The biggest impact on performance was having little exposure to the strong mining sector, although Mothercare also had an effect as the shares fell heavily after a poor trading statement on the UK side of their business. On the positive side, strong gains from media stocks - Daily Mail & General Trust and United Business Media helped performance.

Activity was relatively limited in the month although we took some profits in Carnival after strong performance. Option exercises after rallies in GlaxoSmithKline and Royal Dutch Shell prompted some reinvestment into positions in other relatively resilient businesses like Sainsbury and Centrica which had performed less well and were thus increasingly attractive.

We continue to expect economic growth to be muted at best for a considerable period and we therefore hold a core of large, well-financed, globally diversified businesses operating in less economically sensitive industries and trading at realistic or cheap valuations. However we also have exposure to other high yielding companies where valuations, in our view, fail to reflect the strength of the business franchise and medium term prospects.

Performance (%)



Cumulative Performance (%)

	3 Months	6 Months	1 Year	3 Years	5 Years
Share Price	-4.40	-9.37	-3.03	25.72	-27.88
NAV	-5.40	-10.97	-2.96	30.73	-25.15
FTSE 100	-4.66	-8.66	-2.31	26.66	-9.54
FTSE 350 HY	-1.93	-4.71	1.61	15.17	-21.98

Standardised Past Performance (%)

From To	29.09.06 28.09.07	28.09.07 30.09.08	30.09.08 30.09.09	30.09.09 30.09.10	30.09.10 30.09.11
Share Price	6.70	-35.21	0.42	6.72	-7.40
NAV	2.09	-33.18	-2.02	13.41	-1.34
FTSE 100	8.49	-24.19	4.72	8.08	-7.57
FTSE 350 HY	3.95	-26.21	-0.34	0.32	-2.36

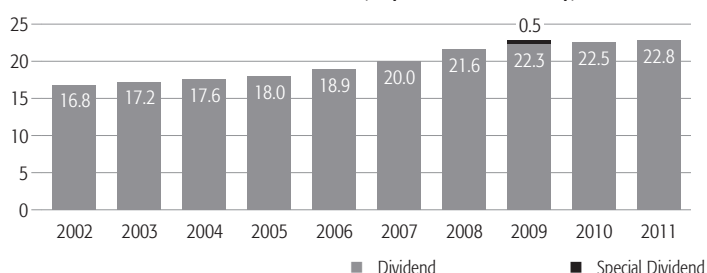
Source: Lipper, share price calculation percentage growth, mid to mid, capital return to 31.10.11.

Benchmark: FTSE 100 Index; FTSE 350 High Yield Index.

Past performance is not a reliable indicator of future performance. You should not make any assumptions on the future on the basis of performance information. The value of an investment and the income from it can fall as well as rise as a result of market fluctuations and you may not get back the amount originally invested. This investment trust charges 65% of its annual management fee to the capital account and 35% to revenue. This could lead to a higher level of income but capital growth will be constrained as a result. Your capital could also decrease if income paid out of capital exceeds the growth rate of the trust.

Dividend History

Ten Year Net Dividend Record in Pence (to year end 31 January)



Net Dividends Paid (financial year to date)

	Pay Date	XD Date	Payment
1st quarterly dividend	17.08.11	15.7.11	5.7p per share
2nd quarterly dividend	11.11.11	7.10.11	5.7p per share



Capital Structure

Total Assets:	£523.5m
Gearing (net):	27.1%
Shares in Issue:	103,213,464 (Ordinary 25p)
Share Price ¹ :	376.5p
Net Asset Value ² :	390.6p (356.9p – debt at market value)
Premium/-Discount to NAV ³ :	-3.6% (5.5% – debt at market value)
NAV Frequency	Daily
Dividend Yield ² :	6.06%

1. Source: Lipper as at 31.10.11, market close mid price.

2. Source: Datastream as at 31.10.11. Calculated using the latest full year dividend divided by the current share price.

3. A trust's net asset value (NAV) is calculated as available shareholders' funds divided by the number of shares in issue, with shareholders' funds taken to be the net value of all the company's assets after deducting liabilities. In line with current industry best practice NAVs are now shown to take into account the 'fair value' of debt. This means NAVs are calculated after allowing for the valuation of debt at fair value or current market price, rather than at final repayment value. NAVs with debt at market value provide a more realistic impact of the cost of debt, and thus a more realistic discount. It is the capital NAV that is shown, which excludes any income.

Key Information

Launch Date:	16 February 1889
AIC Sector:	UK Growth and Income
Benchmark:	FTSE 100 Index FTSE 350 High Yield Index
Annual Management Charge:	0.35%
Performance Fee:	No
Total Expense Ratio: ⁴	0.46%
Year end:	31 January
Annual Financial Report:	Final posted in April, Half-yearly posted in September
AGM:	May
Dividends:	February, May, August, November
Price Information:	Financial Times, The Daily Telegraph, www.rcm.com/investmenttrusts

Board of Directors:
Simon Fraser (Chairman), Mike McKeon (Chairman of the Audit Committee), Henry Staunton (Senior Independent Director), Paul Yates

Company Secretary	Kirsten Salt
Investment Manager	Simon Gergel, Director, UK Equity
Codes:	RIC: MRCH SEDOL: 0580007 ISIN: GB0005800072

4. Source: Annual Financial Report

Risks & Features

Investment trusts are quoted companies listed on the London Stock Exchange. Their share prices are determined by factors including the balance of supply and demand in the market, which means that the shares may trade below (at a discount to) or above (at a premium to) the underlying net asset value.

Merchants seeks to enhance returns for its shareholders through gearing, in the form of long-term, fixed rate debentures. Gearing can boost the Trust's returns when investments perform well, though losses can be magnified when investments lose value. You should be aware that this Trust may be subject to sudden and large falls in value and you could suffer substantial capital loss. Derivatives are used to manage the trust efficiently.

All data source RCM (UK) Limited as at 31.10.11 unless otherwise stated.

Issued by RCM (UK) Limited. Authorised and regulated by the Financial Services Authority. The information contained herein including any expression of opinion is for information purposes only and is given on the understanding that it is not a recommendation and anyone who acts on it, or changes their opinion thereon, does so entirely at their own risk. The opinions expressed are based on information which we believe to be accurate and reliable, however, these opinions may change without notice.

Portfolio Analysis

Top Ten Holdings	(%)	(%)	
Royal Dutch Shell "B" Shares	8.5	Unilever	4.1
GlaxoSmithKline	7.2	BAE Systems	3.5
BP	6.9	Scottish & Southern Energy	3.2
Vodafone	5.7	British American Tobacco	3.1
HSBC	5.4	National Grid	3.0
Total Number of Holdings			62

Sector Breakdown	(%)
Financials	16.85
Oil & Gas	15.55
Consumer Services	14.44
Consumer Goods	12.95
Industrials	10.39
Telecommunications	9.46
Health Care	9.07
Utilities	8.13
Basic Materials	1.76
Cash	1.39
Other	0.01

HOW TO INVEST?

The Trust is a UK public limited company traded openly on the stock market. You can purchase shares through a stock broker. Shares in the Trust can be held within an ISA and/or savings scheme and a number of providers offer this facility. A list of suppliers is available on our website or from the AIC at www.theaic.co.uk

CONTACT US

To download the Annual Financial Report, Trust brochure or watch an interview with the fund manager, please visit us online at www.rcm.com/investmenttrusts



If you have any queries regarding our investment trusts our Investor Services team can be contacted on:

0800 389 4696

e-mail: investment-trusts@uk.rcm.com

website: www.rcm.com/investmenttrusts