

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 Australia. The Trust now concentrates primarily on major UK companies with an above average rate of dividend yield.

Fund Manager's Review

Simon Gergel



The stock market made modest gains in August on very thin trading volumes as investors anticipated policy action in Europe in September to address the high borrowing costs for Southern European countries. Economic news was generally downbeat with falling growth forecasts in the Eurozone in particular. The Chinese economy also showed further signs of slowing with the iron ore price falling heavily in response.

The FTSE 100 Index produced a total return of 2.1% in the month with relatively mixed sector performances. Several cyclical sectors performed well, such as general retailers, chemicals and media, whilst the metals & mining sector fell heavily on Chinese growth concerns. Defensive sectors like tobacco and pharmaceuticals underperformed too, posting modest declines.

The Trust's NAV (+2.3%, total return) outperformed the market helped in particular by the media stocks Reed Elsevier, UBM and DMGT and also Inmarsat which rallied in response to a strong trading update. The biggest negative factor was not owning Glencore or Xstrata which rose sharply in anticipation of completing their proposed merger.

Within the portfolio, we took advantage of a recovery in cyclical stocks to sell Aviva and Hays where significant balance sheet or trading risks remain. A new investment was made in ICAP, one of the leading inter-dealer brokers. ICAP is diversified across voice and electronic trading as well as having a growing and valuable post trade services and information business. Profitability is more affected by market trading activity than by market levels and a recent lack of volatility has created an opportunity to buy the shares on a low valuation with a dividend yield above 6%.

Our outlook remains cautious as economic activity is likely to be constrained by debt de-leveraging by governments and consumers. We continue to hold significant positions in globally diversified, well financed businesses in relatively defensive industries. However we are finding better value in companies that have a degree of industrial or consumer cyclical exposure but nevertheless have strong competitive positions, robust cash flows and decent long term growth prospects.

Performance (%)



Cumulative Performance (%)

	3 Months	6 Months	1 Year	3 Years	5 Years
Share Price	7.7	-1.8	2.5	34.7	-3.1
NAV	12.6	3.9	16.1	40.6	0.3
FTSE 100	8.5	-0.4	10.1	29.4	9.5

Discrete Performance (%)

From	29.06.07	30.06.08	30.06.09	30.06.10	30.06.11
To	30.06.08	30.06.09	30.06.10	30.06.11	29.06.12
Share Price	-22.1	-18.6	23.0	36.5	-6.9
NAV	-23.2	-28.3	24.8	32.5	-1.1
FTSE 100	-11.6	-20.9	19.8	24.9	-2.7

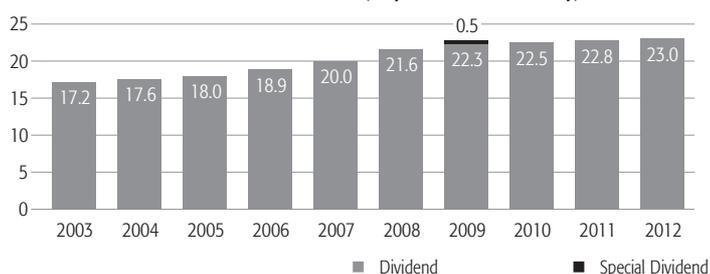
Source: Lipper, share price calculation percentage growth, mid to mid, total return to 31.08.12.

Benchmark: FTSE 100 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 (Financial Year to Date)

	Pay Date	XD Date	Payment
1st quarterly dividend	15.08.12	13.07.12	5.8p per share
2nd quarterly dividend	12.11.12	05.10.12	5.8p per share



Capital Structure

Total Assets:	£546.5m
Gearing (net):	22.3%
Shares in Issue:	103,213,464 (Ordinary 25p)
Share Price ¹ :	364.9p
Net Asset Value ² :	409.9p (370.7p – debt at market value)
Premium/-Discount to NAV ³ :	-11.0% (-1.6% – debt at market value)
NAV Frequency	Daily
Dividend Yield ² :	6.33%

1. Source: Lipper as at 31.08.12, market close mid price.

2. Source: Datastream as at 31.08.12. 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
Annual Management Charge:	0.35%
Performance Fee:	No
Total Expense Ratio: ⁴	0.47%
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 as at 31 January 2012

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.

Portfolio Analysis

Top Ten Holdings	(%)	(%)	
Royal Dutch Shell "B" Shares	8.6	BAE Systems	3.8
GlaxoSmithKline	7.3	British American Tobacco	3.3
BP	6.9	Reed Elsevier	3.3
HSBC	6.3	Scottish & Southern Energy	3.0
Vodafone	5.3	Unilever	3.0
Total Number of Holdings			62

Sector Breakdown	(%)
Financials	16.6
Consumer Services	15.6
Oil & Gas	15.5
Consumer Goods	11.9
Industrials	11.0
Telecommunications	8.6
Utilities	8.3
Health Care	7.3
Cash	3.0
Basic Materials	2.2

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 financial reports, 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:

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All data source RCM (UK) Limited as at 31.08.12 unless otherwise stated.

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