

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 rebounded in June, taking some encouragement from the European summit agreement to ease the terms of a Spanish bail out, in particular by lending money directly into Spanish banks rather than going via the Spanish government.

The stock market rose by around 5% with the strongest performance from the construction sector and financial sectors such as life insurance and banks. The worst performing sectors were industrials such as engineering and oil services, partly due to a sharp fall in the oil price for most of the month.

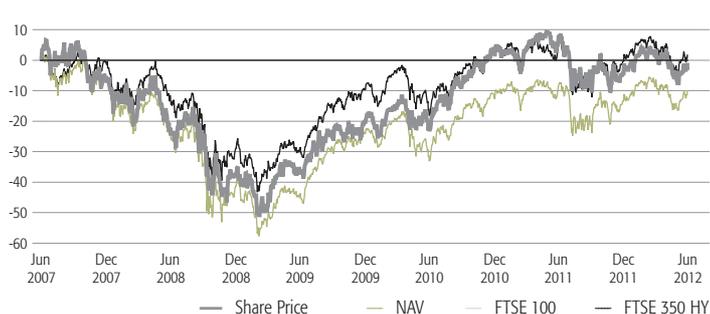
The Trust's NAV returned 6.6% on a total return basis, outperforming the rising market with little impact from sector positioning. Strong performance from stocks like DMGT, Inmarsat, UBM and Greene King was largely offset by underperformance from GlaxoSmithKline, Britvic and Reckitt Benckiser.

There were a number of transactions during the month. We added to positions in Carnival, Inmarsat and Daily Mail & General Trust where valuations look too low compared to the strong competitive positions of the businesses and their growth potential. Conversely we took partial profits in a number of more defensive companies which had performed well such as National Grid, Imperial Tobacco and BT. The remaining position in Legal & General was also sold after a period of strong performance which had moved the shares up to a fair valuation in what remains a mature UK life assurance industry.

Our central view remains that economic growth is likely to remain below trend in the medium term as the high debt burden in most developed countries is worked off. Considerable economic and political risks within the Eurozone further complicate the outlook and the USA is also facing an election later this year which threatens a political vacuum in the next few months.

Despite that background, many companies are trading reasonably well and debt levels have been reduced since the global financial crisis. Valuations in general are not expensive and in some cases are very attractive. Many of the portfolio companies are in industries such as pharmaceuticals, telecoms or utilities which are less exposed to the economic cycle and offer strong cash flow and high dividend yields. However we are also finding opportunities in other areas, such as the consumer sectors, to buy into companies with strong competitive positions that are significantly undervalued on a medium term view.

Performance (%)



Cumulative Performance (%)

	3 Months	6 Months	1 Year	3 Years	5 Years
Share Price	-2.2	3.5	-6.9	56.3	-0.9
NAV	-1.8	4.1	-1.1	63.5	-9.9
FTSE 100	-2.3	2.2	-2.7	45.7	1.9

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

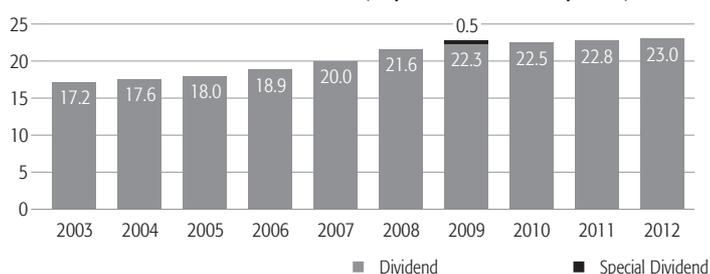
Source: Lipper, share price calculation percentage growth, mid to mid, total return to 30.06.12.

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 2012)



Net Dividends Paid (Financial Year to date)

	Pay Date	XD Date	Payment
1st quarterly dividend	15.08.12	13.07.12	5.8p per share



Capital Structure

Total Assets:	£532.0m
Gearing (net):	22.1%
Shares in Issue:	103,213,464 (Ordinary 25p)
Share Price ¹ :	366.9p
Net Asset Value ² :	393.6p (356.7p – debt at market value)
Premium/-Discount to NAV ³ :	-6.8% (2.9% – debt at market value)
NAV Frequency	Daily
Dividend Yield ² :	6.27%

1. Source: Lipper as at 30.06.12, market close mid price.

2. Source: Datastream as at 30.06.12. 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	8.0	British American Tobacco	3.9
GlaxoSmithKline	7.6	BAE Systems	3.6
BP	6.8	Unilever	3.2
HSBC	6.7	Scottish & Southern Energy	3.2
Vodafone	5.3	National Grid	3.0
Total Number of Holdings		60	

Sector Breakdown	(%)
Financials	16.2
Consumer Services	15.2
Oil & Gas	14.7
Consumer Goods	12.7
Industrials	10.7
Utilities	8.6
Telecommunications	8.4
Health Care	7.6
Cash	3.6
Basic Materials	2.3

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:

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All data source RCM (UK) Limited as at 30.06.12 unless otherwise stated.

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