

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.

Fund Manager's Review

Simon Gergel



Market attention in July was once again focused on the peripheral Eurozone crisis with Spanish and Italian bond yields rising sharply for much of the month, reflecting increasing investor concerns, before falling sharply again at the end of the month. The catalyst for the recovery in sentiment was expectation of action by Eurozone authorities and notably a speech by ECB president Mario Draghi where he said that the European Central Bank would do "whatever it takes" to preserve the Euro. The UK stock market took its cue from the stresses in money markets, falling in the middle of the month before rallying at the end to post a small positive total return. The FTSE 100 Index returned 1.2% with medium sized companies in the FTSE 250 Index gaining just over 2%. Sector performances had little clear theme with relatively strong performance from food & beverages, travel & leisure, technology and insurance whilst laggards included construction, banks and electricity.

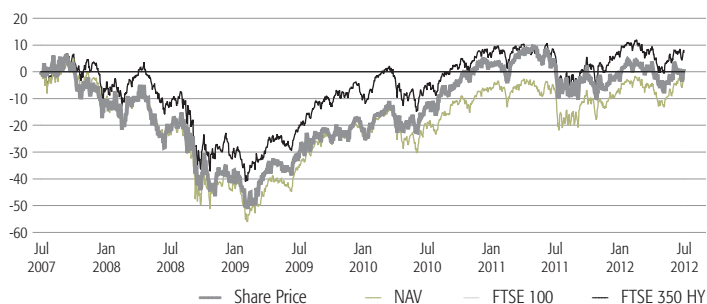
The Trust's NAV (+1.8%) outperformed the FTSE 100 Index in July with notable stock selection gains in the media sector as UBM, DMGT and Reed Elsevier all out-performed in response to robust trading statements. Other positive contributors included owning BAE Systems which rallied and having no exposure to Anglo American which fell back sharply. The biggest negative contributors were Britvic which fell heavily on a product recall and BBA Aviation which also pulled back. Not owning SAB Miller which rose 8% also had a modest impact on relative performance.

There were no new companies added to the portfolio in July but we took advantage of volatility to take some money out of shares that had performed well and thus became less attractively valued, such as Cobham, British American Tobacco, DMGT and IG Group. Conversely we added to positions in selected shares that had underperformed and offered better value, provided that we continue to believe in the strength of the company's business franchise. Examples of these included BBA Aviation, Premier Farnell, Resolution and Royal Dutch Shell.

As we write the stock market is near the top of its trading range for the last four years. Many businesses have been restructured over that time and are now trading reasonably well. However, the fundamental problem of too much debt in the financial system has not been convincingly addressed and growth is likely to remain subdued not just in Europe (including the UK) but also in the USA.

The portfolio remains defensively positioned, due to our macro-economic concerns, and it is orientated to higher yielding stocks which we think are generally well positioned. However we are mindful that many defensive businesses have been re-valued and offer more limited upside from here. Elsewhere we have been able to identify specific opportunities to buy fundamentally strong businesses which trade at attractive prices because the investment community is too pessimistic about their prospects. Several of these are in the media and consumer sectors or the aerospace and defence industries.

Performance (%)



Cumulative Performance (%)

	3 Months	6 Months	1 Year	3 Years	5 Years
Share Price	-1.5	3.5	-2.6	47.8	0.1
NAV	2.4	5.4	4.1	51.0	-3.2
FTSE 100	-0.9	1.4	0.7	35.8	7.1

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

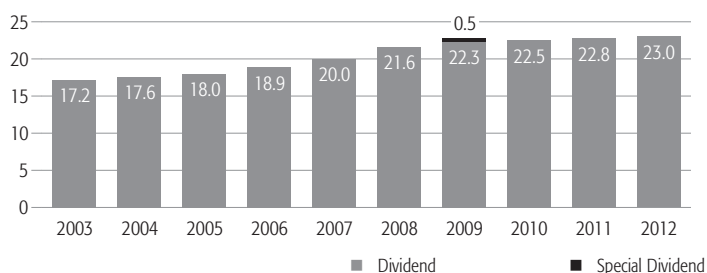
Source: Lipper, share price calculation percentage growth, mid to mid, total return to 31.07.12.

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 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:	£532.7m
Gearing (net):	24.5%
Shares in Issue:	103,213,464 (Ordinary 25p)
Share Price ¹ :	364.1p
Net Asset Value ² :	400.7p (361.1p – debt at market value)
Premium/-Discount to NAV ³ :	-9.1% (0.8% – debt at market value)
NAV Frequency	Daily
Dividend Yield ² :	6.34%

1. Source: Lipper as at 31.07.12, market close mid price.

2. Source: Datastream as at 31.07.12. 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	8.7	BAE Systems	3.8
GlaxoSmithKline	7.6	British American Tobacco	3.5
BP	6.7	Unilever	3.4
HSBC	6.3	Reed Elsevier	3.1
Vodafone	5.4	Scottish & Southern Energy	3.0
Total Number of Holdings		60	

Sector Breakdown	(%)
Financials	16.3
Consumer Services	15.7
Oil & Gas	15.6
Consumer Goods	12.5
Industrials	11.2
Telecommunications	8.6
Utilities	8.3
Health Care	7.7
Basic Materials	2.4
Cash	1.7

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 31.07.12 unless otherwise stated.

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