

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 principally 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 upon major UK companies with an above average rate of dividend yield.

Fund Manager's Review

Simon Gergel



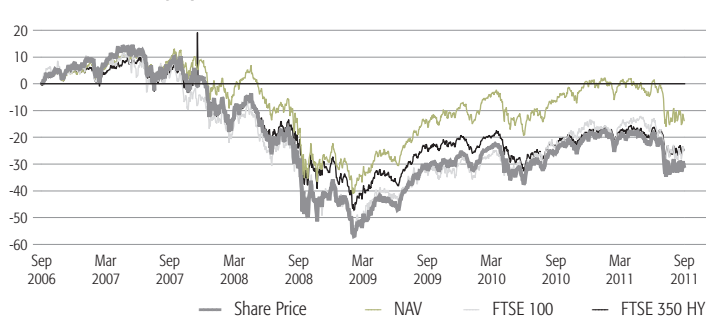
Increased uncertainty over the Eurozone financial crisis dominated market sentiment during the month with equities and many other financial assets falling sharply. Economic releases in Europe were generally pointing to slowing growth although US statistics were more resilient. The US Federal Reserve initiated "Operation Twist" buying long dated bonds and selling shorter dated bonds, which pushed 10 year yields down below 2%. The dollar rallied sharply, up almost 7% against the weakening Euro and gold and copper fell heavily, down 11% and 24% respectively.

The FTSE 100 Index fell by 4.9% with medium sized companies falling more heavily. There was a sharp rotation within the market towards defensive stocks, with sectors like telecommunications, tobacco and pharmaceuticals rising whilst cyclical sectors fell heavily. Mining and basic materials stood out with falls of nearly 20%.

The Trust's portfolio (-3.7%) outperformed its benchmark due to its more defensive positioning with the biggest contribution coming from not owning most mining stocks, but also benefitting from the resilience of stocks like GlaxoSmithKline, Inmarsat and National Grid. There were few significant negative performance factors although Man Group had a poor trading update and we did not own Tullow Oil or Diageo which outperformed.

We made few changes to the portfolio in September with no new holdings added. The portfolio remains cautiously positioned, with a bias towards companies with high yields, strong balance sheets and limited economic sensitivity. Market volatility may well provide interesting investment opportunities in the months ahead although we are conscious that the major Western economies are unlikely to produce more than pedestrian growth in the short and medium term.

Performance (%)



Cumulative Performance (%)

	3 Months	6 Months	1 Year	3 Years	5 Years
Share Price	-14.59	-13.37	-7.40	-0.76	-31.40
NAV	-12.39	-10.49	-1.34	9.63	-25.22
FTSE 100	-13.74	-13.21	-7.57	4.61	-13.96
FTSE 350 HY	-9.23	-7.97	-2.36	-2.38	-25.12

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

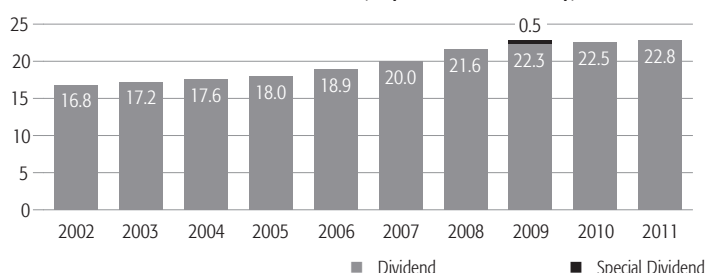
Source: Lipper, share price calculation percentage growth, mid to mid, capital return to 30.09.11.

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	Record 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:	£496.5m
Gearing (net):	27.0%
Shares in Issue:	103,213,464 (Ordinary 25p)
Share Price ¹ :	367.0p
Net Asset Value ² :	360.4p (326.7p – debt at market value)
Premium/-Discount to NAV ³ :	1.8% (12.3% – debt at market value)
NAV Frequency	Daily
Dividend Yield ² :	6.21%

1. Source: Lipper as at 30.09.11, market close mid price.

2. Source: Datastream as at 30.09.11. 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 30.09.11 unless otherwise stated.

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Portfolio Analysis

Top Ten Holdings	(%)	(%)	
Royal Dutch Shell "B" Shares	8.7	Unilever	4.3
GlaxoSmithKline	7.9	BAE Systems	3.6
BP	6.2	Scottish & Southern Energy	3.3
Vodafone	5.3	National Grid	3.3
HSBC	5.3	British American Tobacco	3.1
Total Number of Holdings			60

Sector Breakdown (%)

Financials	16.56	
Oil & Gas	14.84	
Consumer Services	14.14	
Consumer Goods	13.24	
Industrials	10.35	
Health Care	9.64	
Telecommunications	9.13	
Utilities	8.30	
Cash	2.16	
Basic Materials	1.63	
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:

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