

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.

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.

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

May generally saw signs of slowing economic momentum in the USA and Europe with Japan sliding back into recession following its major earthquake. Commodity prices fell sharply early in the month, led by Silver and oil, with the WTI oil price down 10% in May.

The UK equity market was relatively range-bound, with the FTSE 100 Index posting a small negative total return of -0.9% (total return). High yielding shares outperformed, with the FTSE350 Higher Yield Index flat (-0.06%) over the month whilst mid-caps were up +0.7%. The best performing sectors included many defensives like tobacco, beverages and pharmaceuticals as well as general retailers. Laggards included most resource sectors and many financials.

The Trust returned -0.13% (NAV total return, net of fees) with the share price rising 2.10%, outperforming the FTSE 100 Index. Defensive companies like GlaxoSmithkline and Britvic were strong performers and underweight positions in BG, Xstrata and Lloyds Bank also helped. The main negative factors were weak performances from media stocks UBM and DMGT as well as not owning Diageo which rallied.

Investment activity was limited. We took some profits in Hammerson and British Land as the property sector rallied. Elsewhere we added to Royal Dutch Shell where the cashflow is improving rapidly as investment projects ramp up to full production and we added to Bunzl, a modestly priced outsourcing company with reasonable growth prospects. The portfolio is positioned for a prolonged period of modest economic growth, with a significant defensive bias, but we continue to look for higher growth businesses on reasonable valuations and offering decent dividend yields.

Key Information

Total Assets:	£567.3m
Gearing (net):	22.4%
No. of Shares (Ordinary 1p):	103,213,464
Share Price¹:	431.8p
Net Asset Value²:	430.4p (406.3p – debt at market value)
Premium/-Discount to NAV²:	0.3% (6.3% – debt at market value)
Dividend Yield²:	5.28%
Net Dividend per Share:	1st quarterly: 5.7p 2nd quarterly dividend: 5.7p 3rd quarterly dividend: 5.7p final dividend: 5.7p, paid 13 May 2011
No. of Holdings:	61

All data source RCM (UK) Limited as at 31.05.11 unless otherwise stated.

Launch Date:	16 February 1889
AIC Sector:	UK Income Growth
Benchmark:	FTSE 100 Index
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
Investment Manager:	Simon Gergel, Director, UK Equity RCM A company of Allianz Global Investors
Investor Services:	0800 389 4696

¹Source: Lipper as at 31.05.11, market close mid price.

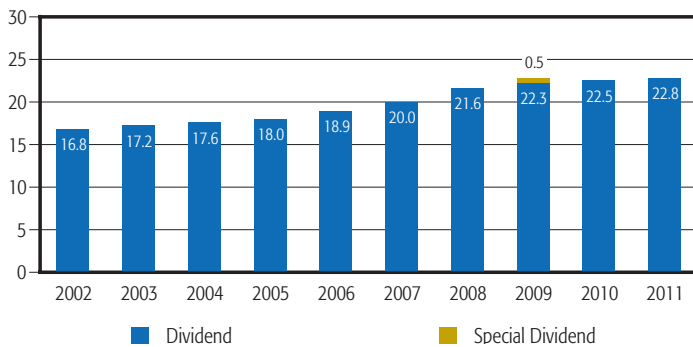
²Source: Datastream as at 31.05.11. Calculated using the latest full year dividend divided by the current share price.

³A 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.

Top Ten Holdings (%)

Name	%
Royal Dutch Shell "B" Shares	8.3
GlaxoSmithKline	7.3
HSBC	6.7
BP	6.5
Vodafone Group	4.7
Scottish & Southern Energy	3.9
Unilever	3.9
BAE Systems	3.7
BHP Billiton	3.2
National Grid	2.8
Total	51.0

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



Net dividend paid per share in pence

Sector Breakdown (%)



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.

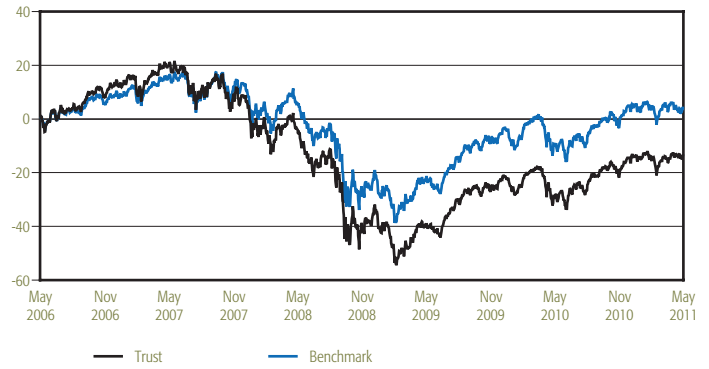
RIC: MRCH **SEDOL:** 0580007 **ISIN:** GB0005800072

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 www.rcm.com/investmenttrusts or from the AIC at www.theaic.co.uk

Please note: Our Investment Trust Savings Plan was closed and transferred to Alliance Trust Savings on 29 February 2008. Alliance Trust can be contacted on 01382 573 737 or contact@alliancetrust.co.uk

Performance

Five Year Trust Performance (%)



Cumulative Performance (%)

	3 Months	6 Months	1 Year	3 Years	5 Years
Share Price	0.88	11.18	21.67	-9.45	-13.13
Benchmark	-0.07	8.35	15.45	-1.05	4.65

Standardised Past Performance (%)

From	31.03.06	30.03.07	31.03.08	31.03.09	31.03.10
To	30.03.07	31.03.08	31.03.09	31.03.10	31.03.11
Share Price	7.48	-18.64	-44.20	55.86	4.53

Source: Lipper, percentage growth, mid to mid, capital return, to 31.05.11

Benchmark: FTSE 100 Index

Standardised past performance figures comply with the Financial Services Authority's regulations to enable investors to compare different products from different providers.

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.

RCM Advantage

RCM and its predecessors have been managing investment trusts since 1889, providing investors with access to investment markets around the world through professionally managed portfolios. Each trust benefits from the expertise of the RCM fund managers yet, as a company listed on the London Stock Exchange, it is independent and is overseen by its own Board of Directors.

RCM is the global equity specialist within Allianz Global Investors. With offices strategically located in the US, Europe and Asia, RCM uses its global research platform to search out investment opportunities.

All data source RCM (UK) Limited as at 31.05.11 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.