

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



The Merchants Trust portfolio comprises predominantly high yielding, large capitalisation UK equities to match the objectives of delivering a high and rising level of income, together with capital growth.

Stock markets fell heavily in May driven by weaker economic statistics coming out of the USA, concern over the on-going growth slowdown in China and significant pressure building within the Eurozone. In Europe the focus shifted from the political vacuum in Greece to the need to recapitalise the Spanish banking industry with no clear agreement on how to proceed towards greater fiscal and political harmonisation.

The FTSE 100 Index fell by almost 7% with medium and smaller sized companies performing broadly in line. There was a significant polarisation within the market: The more cyclical industries fell the most with basic resources and banks posting double digit declines, whilst more defensive sectors like healthcare, telecoms or utilities were broadly unchanged. Consequently higher-yielding shares generally outperformed.

The Trust's NAV performed in line with the FTSE 100 (-6.95%) however the Trust's equity portfolio significantly outperformed the broader equity market, before the impact of gearing. The key drivers of the outperformance were large positions in relatively resilient shares like GlaxoSmithKline, SSE and National Grid, as well as avoiding most of the pain in the mining and (domestic) banking sectors where the portfolio has very modest exposure.

We made several changes to the portfolio during the month. A new position was introduced in Marstons, a pub and brewing company which is trading well despite a difficult consumer environment and owns a valuable property portfolio which underpins the investment case along with a 6% dividend yield. We sold the remaining Tesco holding, preferring to consolidate our food retail exposure through Sainsburys.

Elsewhere, we sold out of Bunzl at a significant profit as the shares now look fully valued after a significant re-rating in a nervous stock market. Another significant change was the first addition in the mining sector for a considerable time. We added to the BHP Billiton holding after a prolonged period of weakness had brought the valuation down to a more attractive level.

Our central view remains that economic growth will continue at a sub-trend level for a considerable time as high debt burdens are addressed around the world. The risks to this view may well be to the downside with political differences hindering effective policy action within the Eurozone as well as in the USA. However many companies are delivering solid operating results, balance sheets have been rebuilt since the global financial crisis and dividends are growing. Furthermore equity valuations are reasonable on a long term basis.

The portfolio continues to be biased towards defensive businesses in industries such as pharmaceuticals, utilities and telecommunications which are less exposed to economic risks. However these businesses are no longer as cheap as they were and we are finding interesting investment opportunities among more cyclical businesses with strong competitive positions, trading at attractive valuations.

Performance (%)



Cumulative Performance (%)

	3 Months	6 Months	1 Year	3 Years	5 Years
Share Price	-8.9	-3.5	-15.3	41.3	-14.2
NAV	-7.7	-1.3	-9.0	48.7	-16.9
FTSE 100	-8.3	-1.5	-7.7	34.0	-3.0

Discrete Performance (%)

From	30.03.07	31.03.08	31.03.09	31.03.10	31.03.11
To	31.03.08	31.03.09	31.03.10	31.03.11	30.03.12
Share Price	-18.7	-39.3	64.3	21.5	-1.4
NAV	-15.4	-40.7	67.5	10.7	3.5
FTSE 100	-6.3	-28.2	50.4	7.4	1.2

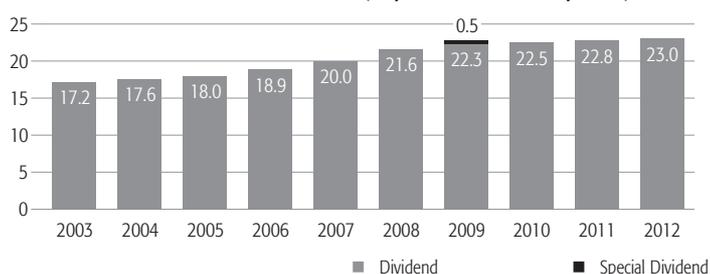
Source: Lipper, share price calculation percentage growth, mid to mid, total return to 31.05.12.

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	17.08.11	15.07.11	5.7p per share
2nd quarterly dividend	11.11.11	7.10.11	5.7p per share
3rd quarterly dividend	23.02.12	27.01.12	5.8p per share
Final dividend	14.05.12	13.04.12.	5.8p per share



Capital Structure

Total Assets:	£505.9m
Gearing (net):	26.3%
Shares in Issue:	103,213,464 (Ordinary 25p)
Share Price ¹ :	344.1p
Net Asset Value ² :	369.4p (330.3p – debt at market value)
Premium/-Discount to NAV ³ :	-6.8% (4.2% – debt at market value)
NAV Frequency	Daily
Dividend Yield ² :	6.68%

1. Source: Lipper as at 31.05.12, market close mid price.

2. Source: Datastream as at 31.05.12. 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	(%)	(%)	
GlaxoSmithKline	7.9	British American Tobacco	3.8
Royal Dutch Shell "B" Shares	7.8	Scottish & Southern Energy	3.7
BP	6.7	BAE Systems	3.6
HSBC	6.4	National Grid	3.3
Vodafone	5.9	Unilever	3.3
Total Number of Holdings		64	

Sector Breakdown	(%)
Financials	16.5
Oil & Gas	14.5
Consumer Services	13.7
Consumer Goods	13.3
Industrials	10.9
Utilities	9.5
Telecommunications	9.2
Health Care	7.9
Basic Materials	2.3
Cash	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 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 31.05.12 unless otherwise stated.

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