

## 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

November's shock in Dubai, a sovereign debt downgrade for Greece and concerns about government debt levels in general, led to sharply rising bond yields around the world, with US 10 year yields rising from 3.2% to 3.8% and UK gilts yields rising over 4%. Nevertheless, equity markets were strong, helped by a robust US employment report and a partial bail out of Dubai.

The FTSE 100 index rose over 4%, giving a 27% total return for 2009. The market gains were far broader than in previous months with several "defensive" sectors like tobacco and food producers posting good gains along with more cyclical areas. Lagging sectors included banks, telecoms and retailers.

The Trust's performance was ahead of the index with defensives like BAE Systems, Reed Elsevier and Unilever performing well and IG Group up 20%. Negatives were fewer but included as sharp pull back in Pendragon and not owning Rio Tinto and Imperial Tobacco which both rallied. Portfolio activity was limited to reducing positions in companies that had performed well and looked less attractive, like BT and National Grid and adding to relative underperformers, like British Land and SSE.

Looking into 2010 we remain of the view that we will see a more stable environment than over the last two years but a high debt overhang limits the scope for strong economic growth. Differentiation between companies rather than sectors is likely to be more important in a slow economic environment. Valuation could be a more important driver of stock performance as well as other fundamentals like business quality and competitive advantage. The portfolio has a high exposure to large, well capitalised companies with strong cash flows, low valuations and high dividend yields. We have also added attractively valued higher growth businesses to the portfolio in recent months.

## Key Information

<b>Total Assets:</b>	£519.3m
<b>Gearing (net):</b>	25.9%
<b>No. of Shares (Ordinary 1p):</b>	103,213,464
<b>Share Price<sup>1</sup>:</b>	343.5p
<b>Net Asset Value<sup>2</sup>:</b>	390.9p (376.1p – debt at market value)
<b>Premium/-Discount to NAV<sup>2</sup>:</b>	-12.1% (-8.7% – debt at market value)
<b>Dividend Yield<sup>2</sup>:</b>	6.52%
<b>Net Dividend per Share:</b>	1st interim: 5.6p (payable 19.8.09) 2nd interim: 5.6p (payable 12.11.09) 3rd interim 5.6p (payable 19.2.10)
<b>No. of Holdings:</b>	45

All data source RCM (UK) Limited as at 31.12.09 unless otherwise stated.

<b>Launch Date:</b>	16 February 1889
<b>AIC Sector:</b>	UK Income Growth
<b>Benchmark:</b>	FTSE 100 Index
<b>Year end:</b>	31 January
<b>Annual Financial Report:</b>	Final posted in April, Half-yearly posted in September
<b>AGM:</b>	May
<b>Dividends:</b>	February, May, August, November
<b>Price Information:</b>	Financial Times, The Daily Telegraph, www.rcm.com/investmenttrusts
<b>Board of Directors:</b>	Hugh Stevenson (Chairman), Simon Fraser Dick Barfield, Mike McKeon, Sir James Sassoon, Henry Staunton
<b>Investment Manager:</b>	Simon Gergel, Director, UK Equity RCM A company of Allianz Global Investors
<b>Investor Services:</b>	020 7065 1407

<sup>1</sup>Source: Lipper as at 31.12.09, market close mid price.

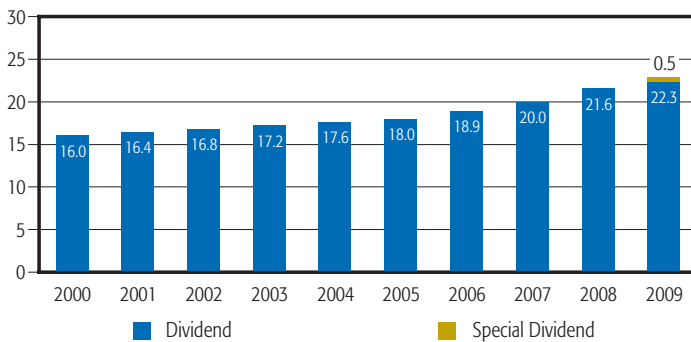
<sup>2</sup>Source: Datastream as at 31.12.09. Calculated using the latest full year dividend divided by the current share price.

<sup>3</sup>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.

## Top Ten Holdings (%)

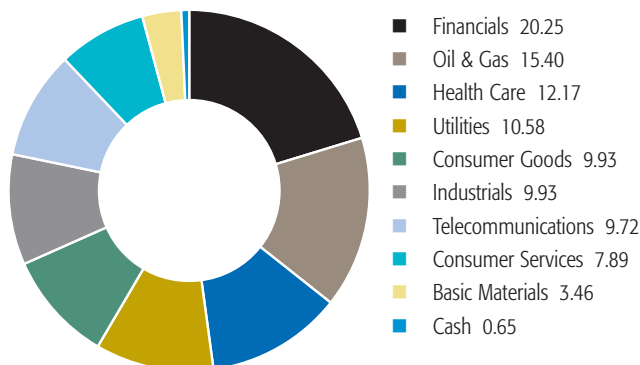
Name	%
Royal Dutch Shell "B" Shares	8.5
GlaxoSmithKline	8.0
Vodafone Group	7.7
HSBC	6.9
BP	6.6
AstraZeneca	4.0
BAE Systems	4.0
Scottish & Southern Energy	3.8
Unilever	3.7
British American Tobacco	3.7
<b>Total</b>	<b>56.9</b>

## 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.

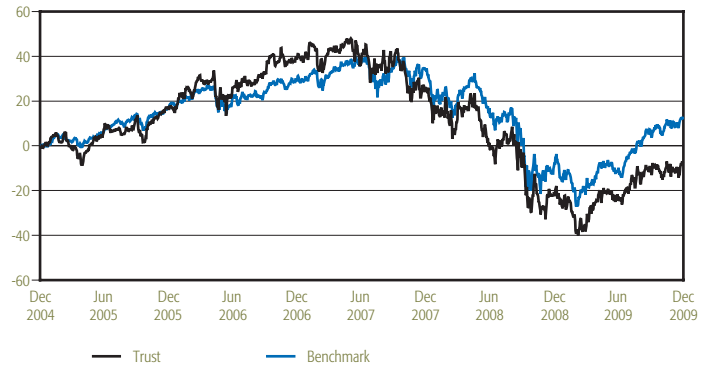
**RIC:** MRCH    **SEDOL:** 0580007    **ISIN:** GB0005800072

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](http://www.rcm.com/investmenttrusts) or from the AIC at [www.theaic.co.uk](http://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](mailto:contact@alliancetrust.co.uk)

## Performance

### Five Year Trust Performance (%)



### Cumulative Performance (%)

	3 Months	6 Months	1 Year	3 Years	5 Years
Share Price	4.73	21.38	18.86	-33.30	-7.29
Benchmark	5.43	27.39	22.07	-12.99	12.43

### Standardised Past Performance (%)

From	31.12.04	30.12.05	29.12.06	31.12.07	31.12.08
To	30.12.05	29.12.06	31.12.07	31.12.08	31.12.09
Share Price	16.46	19.35	-9.51	-37.98	18.86

Source: Lipper, percentage growth, mid to mid, capital return, to 31.12.09

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.

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