Quarterly Update

City Merchants High Yield Trust Limited

July 2019 (covering the 3 months ending 30 June 2019)

This document is for Professional Clients only and is not for consumer use.

Market and economic comment

High yield corporate bonds continued to rally during the second quarter of 2019. Sentiment during the period responded to trade tensions and to an expectation central banks would soon begin easing policy.

- Index data from ICE BofAML shows that European Currency High Yield had its best second quarter of returns since 2009.
- Trade tensions were a feature throughout the quarter, particularly between the US and China. However, the announcement in May that the US proposed tariffs on Mexican imports had a particularly negative impact on sentiment. The subsequent decision to not go ahead and implement tariffs helped markets to recover strongly in June.
- The US Federal Reserve opened the door to cutting interest rates potentially as early as July 2019.
- European Central Bank president, Mario Draghi signalled that the ECB was looking at further measures to ease policy, potentially including a resumption of Quantitative Easing.
- There were reports (now confirmed) that troubled lender Deutsche Bank would significantly cut back its US equities trading. The move to cut costs saw its bonds rally as credit risk improved.
- Tesco was upgraded to Baa3 from Ba1 by Moody's. This means it is now ranked investment grade by two of the major rating agencies and so is eligible for inclusion with many IG indices.

Summary of bond market returns

Sector	Yield (%) Jun-19	Yield (%) 3 Month Change	Spread (Bps) Jun-19	Spread (Bps) 3 Month Change	Total Return
Governments					
Gilts	1.05	-0.09	-	-	1.4%
Bunds	-0.44	-0.20	-	-	2.0%
US Treasuries	1.94	-0.45	-	-	3.1%
European High Yield (inc € + £)	**3.99**	**-0.32**	**384**	**-28**	**2.4%**
BB	2.72	-0.37	266	-35	2.7%
B	5.96	-0.13	553	-12	1.7%
CCC and lower	12.66	0.35	1245	54	1.9%
US High Yield	**6.45**	**-0.29**	**407**	**2**	**2.6%**
BB	4.83	-0.30	243	-1	3.2%
B	6.74	-0.34	434	-4	2.4%
CCC and lower	12.20	0.21	997	61	0.6%
High Yielding Investment Grade					
Sterling BBB rated	**2.83**	**-0.22**	**184**	**-13**	**2.5%**
Euro BBB rated	**0.97**	**-0.33**	**142**	**-17**	**2.5%**

Source: Bloomberg LP, Merrill Lynch data. (local currency returns).

Spread is the Option Adjusted Spread. Bps is basis points (each unit is 1/100th of a 1%). Yield and spread data includes the effect of index rebalancing undertaken on the last day of the month. Changes in the composition of the index can effect the index yield and spread.

Data as at 30 June 2019

Past performance is not a guide to future returns.

Portfolio performance*

The investment company's NAV rose by 3.4% over the three-month period to the 30 June 2019.

Portfolio performance benefitted from the strong rally in bond markets. With yields falling across the board, returns were positive across most sectors. The highest contribution came from the allocation to additional tier 1 bank bonds, telecoms insurance and retail companies.

Performance (% growth)	Ord. Share Price	NAV
YTD	13.5	8.6
2018	-7.6	-3.6
2017	9.9	8.7
2016	11.6	12.2
2015	0.7	2.7
2014	8.5	5.2
3 months	9.1	3.4
6 months	13.5	8.6
1 year	6.7	6.3
3 years	27.1	24.8
5 years	32.2	31.9
10 years	195.6	200.0

For source and basis of this data, see Important information overleaf.

Standardised rolling 12-month performance (% growth)

	30/06/14 30/06/15	30/06/15 30/06/16	30/06/16 30/06/17	30/06/17 30/06/18	30/06/18 30/06/19
Ord. Share Price	3.5	0.5	17.9	10	6.7
NAV	3.5	2.1	16.1	12	6.3

Past performance is not a guide to future returns. This information is updated on a
For source and basis of this data, see Important information overleaf.

Strategy and outlook

The portfolio holds a core of non-financial high yield corporate bonds, focused on seasoned issuers that we consider have a low likelihood of default. Alongside these core positions the portfolio also has a smaller allocation across all sectors to more speculative positions. The expectation with these bonds is that the return, if our analysis is correct, will come from both capital appreciation and income.

At a sector level the portfolio's largest exposure is to the financial sector through both subordinated bank bonds and subordinated insurance bonds. As at 30 June 2019, 36% of the company is invested in this area of the market. Elsewhere, the portfolio's largest allocations are to telecoms, food, utility and retail companies.

The company exploits opportunities in both the European and US markets. As at 30 June 2019, 35% of the portfolio is allocated to US dollar denominated bonds and a further 14% allocated to euro denominated bonds. Most of the currency exposure from these positions is hedged back to sterling with around 9% left in US dollars and 2% in euros at the end of June 2019.

The dovish shift by central banks has re-ignited the search for yield and investor demand for new issues is very strong. That said credit spreads and the overall level of yield have fallen back below their 5-year averages and so we must expect the strong gains we enjoyed in the first quarter of 2019 to moderate from this point. We have therefore dialled back some of the risk in the portfolio. That said, not all bonds have rallied. A meaningful number of bonds continue to trade at significant discounts to par. The extent of this dispersion is greater than we have seen for some time. In our view it most likely reflects market concerns about the potential for credit problems when this very long period of economic expansion ends. It is also creating opportunities for us to buy bonds at what we believe are appropriate yields.

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Investment team

Paul Causer: After graduating in Economics from the London School of Economics in 1983, Paul began his career with Asahi Bank in research, before moving to the bank's Treasury department. In 1990 he was given responsibility for managing the bank's multi-currency investment portfolio. Paul joined Invesco (formerly Perpetual) in 1994.

Paul Read: Paul graduated in Economics and History from the University of Toronto in 1984 and has an MBA from INSEAD. He began his career with UBS (Securities) Ltd, moving to Merrill Lynch International in 1988. Paul initially worked on bond sales, before moving on to debt trading and working as a director of fixed income trading in Tokyo. Paul joined Invesco (formerly Perpetual) in 1995.

Rhys Davies: Rhys began his investment career within Invesco's Product Support team in January 2002 before moving to the Henley-based Fixed Interest team in November 2003. In 2014 he was appointed deputy fund manager for the City Merchants High Yield Trust Limited and the Invesco Perpetual Enhanced Income Limited, before being promoted to fund manager in 2016. He holds a BSc (Honours) in Management Science from the University of Manchester Management School and is a CFA charterholder.

Investment Risks

The value of investments and any income will fluctuate (this may partly be as a result of exchange rate fluctuations) and investors may not get back the full amount invested.

The portfolio has a significant proportion of high-yielding bonds, which are of lower credit quality and may result in large fluctuations in the NAV of the product.

The product uses derivatives for efficient portfolio management which may result in increased volatility in the NAV.

The use of borrowings may increase the volatility of the NAV and may reduce returns when asset values fall.

The product may invest in contingent convertible bonds which may result in significant risk of capital loss based on certain trigger events.

Important Information

*Ordinary share price performance figures have been calculated using daily closing prices with dividends reinvested. NAV performance figures have been calculated using daily NAV with dividends.

All performance figures are in sterling as at 30 June 2019 except where otherwise stated.Source: Thomson Reuters Datastream

Where individuals or the business have expressed opinions, they are based on current market conditions, they may differ from those of other investment professionals and are subject to change without notice.

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For more information on our products, please refer to the relevant Key Information Document (KID), Alternative Investment Fund Managers Directive document (AIFMD), and the latest Annual or Half-Yearly Financial Reports. This information is available using the contact details shown.

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