EDISON

City Natural Resources High Yield Trust

Improving fundamentals in 2014

Investment trusts

City Natural Resources High Yield Trust (CYN) provides diversified exposure to the resources sector with a focus on income. A broad decline in commodity prices coupled with the relative underperformance of smaller-cap resources shares over the last two years has been particularly unhelpful for CYN's performance. In contrast, the current year has started positively with a stabilisation in commodity prices and a still improving global economic outlook. The managers see positive or improving dynamics in the oil & gas, gold and palm oil sectors, which represent over 60% of the current portfolio.

12 months ending	Total share price return (%)	Total NAV return (%)	Composite Benchmark (%)	Euromoney Global Mining TR GBP (%)	CRB Commodity TR GBP (%)
31/05/11	71.9	59.2	18.9	22.2	21.4
31/05/12	(28.5)	(32.4)	(24.2)	(30.6)	(16.6)
31/05/13	(30.0)	(23.2)	(2.2)	(7.4)	4.9
30/05/14	(5.4)	(13.8)	(7.4)	(9.1)	(2.0)

Note: *Twelve-month rolling discrete performance.

Investment strategy: Diversified resources focus

CYN's investment objective is to generate capital growth and income through investing primarily in natural resources equities and fixed income securities. The portfolio maintains a diversified exposure across oil & gas, mining and agricultural commodities with a small-/mid-cap bias. The managers' investment process is primarily based on bottom-up stock selection drawing on industry experience, management meetings and valuation analysis. This is supported by a top-down overlay and broader themes, such as the development of unconventional oil and gas with favourable risk reward characteristics, are also evident in the portfolio holdings. Reflecting the income element of the mandate, c 25% of investments are in fixed income instruments issued by mining, financial and industrial companies.

Sector outlook: Differentiated drivers

After two years of broad decline, 2014 has started positively for the sector with an overall stabilisation in commodity prices and significant increases for a number, where improving supply demand fundamentals are having a beneficial impact including gold, nickel and palm oil. Although unconventional projects continue to increase global production capacity, there appears to be continued support for oil and gas prices at current levels due to ongoing oil supply disruptions and replenishment of gas storage from historically low levels. Political tensions in the Ukraine and associated concerns over Russian oil and gas supplies provide further support for prices as demand increases for alternative sources of supply.

Valuation: Discount at lower-end of historical range

Changing sentiment in the resources sector has probably contributed to some volatility in the discount over the last year but it has recently narrowed quite sharply to 9%. This leaves it below the 14% three-year average but still above the low of 2%. CYN has a yield of c 4% and is one of only five dividend-paying trusts in the peer group.

5 June 2014

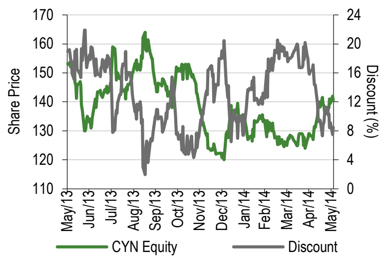
Price	**140.5p**
Market cap	**£94.0m**
AUM	**£140.9m**

NAV*	153.5p
Discount to NAV	8.5%
Yield	3.9%

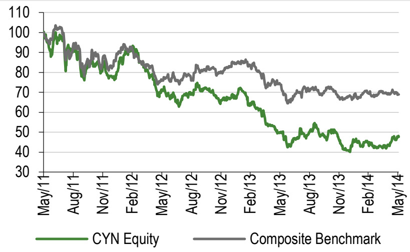
*Adjusted for debt at market value, including income as at 30 May 2014.

Ordinary shares in issue	66.9m
Code	CYN
Primary exchange	LSE
AIC sector	SS: Commodities & Natural Resources

Share price/discount performance*



Three-year cumulative perf. graph



52-week high/low	164.0p	120.0p
NAV** high/low	184.6p	140.3p

**Including income.

Gearing

Gross*	35.3%
Net*	21.0%

*As at 30 April 2014.

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Edison profile page

City Natural Resources High Yield Trust is a research client of Edison Investment Research Limited

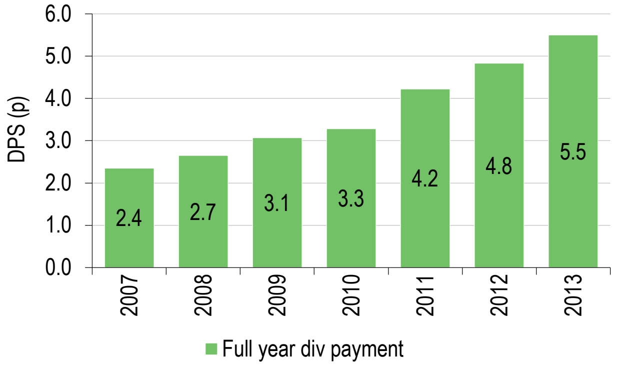
Exhibit 1: Trust at a glance

Investment objective and fund background	Recent developments
CYN's investment objective is to provide shareholders with capital growth and income predominantly from a portfolio of mining and resource equities, and of mining, resource and industrial fixed interest securities.	28 February 2014: Interim results for six months to 31 December 2013. 22 January 2014: Second interim dividend declared at 0.86p.

Forthcoming		Capital structure		Fund details	
AGM	December 2014	Ongoing charges	1.47%	Group	New City Investment Managers
Preliminary results	September 2014	Net gearing	21.0%	Managers	Will Smith, Ian Francis
Year end	30 June	Annual mgmt fee	1.19% of net assets	Address	5th Floor, 33 Chester Street, London SW1X 7BL UK
Dividend paid	Quarterly	Performance fee	None		
Launch date	August 2003	Trust life	Indefinite	Phone	+44 (0)20 7201 6900
Continuation vote	Annually	Loan facilities	None – geared using CULS	Website	www.ncim.co.uk

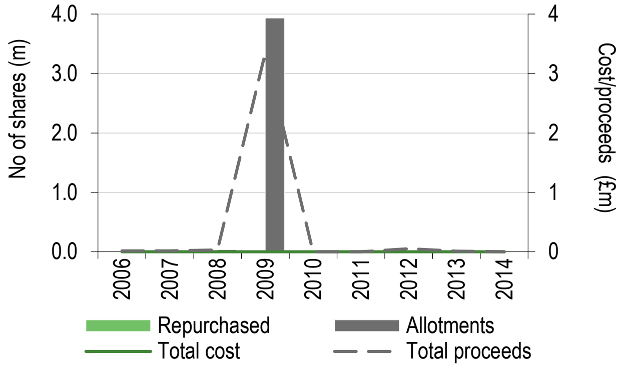
Dividend policy and history

CYN aims to at least maintain the level of dividends paid in respect of each financial year although there is no guarantee that this will be achieved.

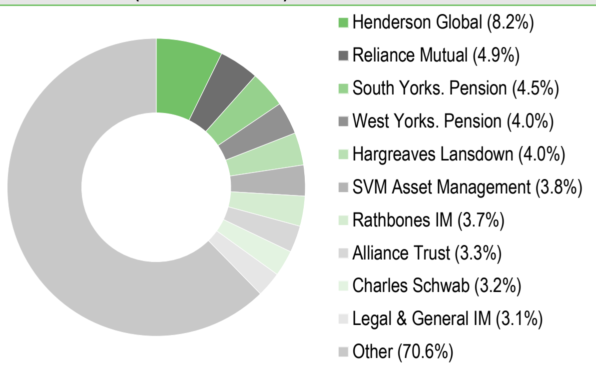


Share buyback policy and history

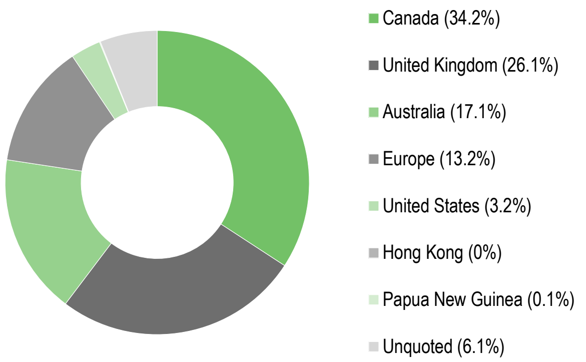
Subject to annual renewal, CYN is authorised both to repurchase and allot up to 14.99% of its ordinary shares.



Shareholder base (as at 3 June 2014)



Distribution of portfolio by stock market listing (as at 31 December 2013)



Top 10 holdings (as at 30 April 2014)

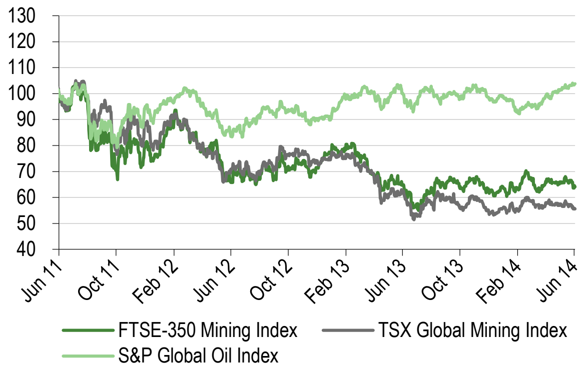
			Portfolio weight %	
Company	**Country**	**Commodity**	**30 April 2014**	**30 April 2013***
REA Holdings	UK	Palm Oil	6.2	4.8
Vermilion Energy	Canada	Oil & Gas	5.0	1.4
New Britain Palm Oil	UK	Palm Oil	3.4	2.4
Sirius Resources	Australia	Nickel	2.8	2.9
Iona Energy 9.5% 2018	Canada	Oil & Gas	2.4	N/A
ARC Resources	Canada	Oil & Gas	2.1	N/A
Surge Energy	Canada	Oil & Gas	2.1	N/A
Ocean Rig 7.25% 2019	Marshall Islands	Oil & Gas	1.8	N/A
Diamorph 12% 2017	Sweden	Other investments	1.6	1.3
Crescent Point Energy	Canada	Oil & Gas	1.5	1.2
Top 10			**28.9**	**N/A**

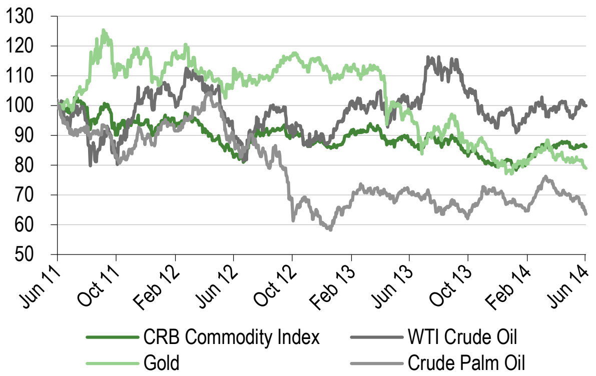
Source: City Natural Resources High Yield Trust. Note: *Where no figure is shown for 2013 portfolio weight, the stock was not in the top 20.

Market outlook: Positive medium-term perspective

There has been a general downtrend in prices across commodity groups over the past three years as reflected by the CRB Commodity Index, which constitutes a broad commodity basket weighted 39% energy, 13% industrial metals, 7% precious metals and 41% agriculture. However, there has been a marked contrast between the performance of mining and oil & gas sector equities as highlighted in Exhibit 2. While the oil & gas sector as a whole has withstood relatively modest price pressure, falling commodity prices combined with considerable cost inflation across the mining industry has resulted in significantly reduced profitability with a consequent decline in valuations.

Exhibit 2: Resources equity indices and commodity prices over three years, rebased





Source: Bloomberg, Edison Investment Research

Despite recent concerns over slowing Chinese economic growth, as highlighted in the IMF's April 2014 World Economic Outlook, global activity has been broadly strengthening and is expected to improve further in 2014-15. This provides a positive backdrop for near-term global commodity demand and prices. Across the mining industry, development projects have been curtailed by companies' current focus on improving profitability and this increases the potential for longer-term supply deficits across industrial commodities as demand continues to rise. In the oil & gas sector, increasing supply from unconventional projects in the United States is rapidly changing the industry's dynamics and could be expected to weigh on oil and gas prices. However, ongoing disruption in oil output from countries such as Libya and the threat of Russian exports being restricted mean that a geopolitical risk premium continues to be reflected in prices.

Fluctuating market expectations over the speed of global economic recovery, the risk of further economic slowdown in China, and duration of QE tapering are likely to affect both commodity prices and resources companies' share prices in the near term. However, the relative stability of resources equities since mid-2013 is considered by some to indicate that the sector is bottoming out and increasingly positive supply demand fundamentals provide scope for upside across the sector.

Fund profile: Natural resources focus

CYN was launched in August 2003. Its investment objective is to provide capital growth and income predominantly from a portfolio of mining and resource equities and of mining, resource and industrial fixed interest securities. Up to 15% of gross assets may be invested in other investment trusts and companies and a minority of gross assets may also be invested in convertible securities and bonds issued by commercial and investment companies. Performance is measured against a composite benchmark, weighted two-thirds to the Euromoney World Mining Index and one-third to the Credit Suisse High Yield Index. CYN has been managed since April 2005 by New City Investment Managers (NCIM), owned by CQS, a global multi-strategy asset manager with

US$13bn under management. The portfolio is co-managed by Will Smith and Ian Francis who are supported by Keith Watson and Rob Crayfourd. Will Smith is primarily responsible for equity investments within the portfolio while Ian Francis focuses on fixed interest securities.

The fund managers: Will Smith and Ian Francis

The manager's view: Favouring unconventional oil & gas

Will Smith believes unconventional oil and gas projects currently offer the greatest returns across the mining and resource sectors with internal rates of return on projects of 40% not considered exceptional compared with average mining project returns of 17-20%. Oil & gas remains the preferred sector and unconventional onshore exploration projects are favoured where the manager considers the geology is much more predictable than conventional offshore exploration projects providing greater chances of exploration success. While capital allocations are moving away from conventional to unconventional exploration projects, overall capital expenditure is increasing across the oil & gas sector and services companies are expected to benefit from this trend. The manager's view is that gas prices remain capped by large-scale recent discoveries increasing market supply although current prices should be supported by the replenishment of gas storage from historically low levels and ongoing oil supply disruptions are expected to support an elevated oil price. Given this outlook, within the 37% exposure to the oil & gas sector, the portfolio's c 90% weighting towards unconventional producers is expected to be maintained and no change is planned in the relative oil:gas exposure of around 75:25.

The manager considers that the decline in the gold price during 2013 was largely driven by investment outflows and believes recent data indicates these outflows have abated. Given the apparent stabilisation of investment outflows, he has a more positive outlook for the gold price and expects to maintain the current gold sector weighting in the portfolio. M&A activity within the gold sector has been increasing and the manager has a focus on companies operating in lower-risk jurisdictions such as Canada and Australia, which he believes are more likely to benefit from this trend. Valuations are considered to be more attractive among smaller companies that experienced greater valuation compression than large-cap gold producers during the gold price correction, and exposure to the larger producers in the portfolio is therefore limited.

Across the industrial commodities, the manager has a positive outlook on the nickel market, expecting that, while uncertainty remains due to the ongoing election process, the Indonesian coalition government will uphold a tough stance on the mining sector. As a result, he expects Indonesian mineral export restrictions introduced in November 2013 to be maintained, which he considers likely to support continued strength in the nickel price with limited available alternative sources of nickel supply globally. Russia is a leading global nickel producer and concerns over potential export restrictions are providing further support to prices.

The palm oil price strengthened in late 2013 and early 2014 and, despite retracing in May 2014, the average price year-to-date is similar to the 2013 average in contrast to the decline over 2011 and 2012 which weighed on portfolio performance. Although prices remain volatile, the manager believes the palm oil producers held in the portfolio should benefit from rising harvesting yields.

Asset allocation

Investment process: Bottom-up with top-down overlay

CYN's investment process is primarily based on bottom-up stock selection supported by a top-down overlay. An assessment of the macroeconomic environment through fundamental research and interaction with CQS trading teams identifies broader themes that are taken into consideration in the stock selection process including geopolitical concerns, currency trends, market liquidity and sentiment. Additionally, sector analysis is performed addressing global demand factors to establish an asset allocation overlay. Stock selection is performed by an experienced team with extensive industry knowledge and is based on management meetings and detailed valuation analysis. A range of valuation metrics are considered to identify undervalued assets and valuations are stress-tested at a range of commodity price forecasts.

Current portfolio positioning

Although the total number of equity and fixed income issues in the portfolio has increased from 190 at 30 April 2013 to 196 at 30 April 2014, portfolio concentration in terms of company exposure has increased. The top 10 holdings weighting has risen from 23.6% to 28.9% and the top 20 holdings weighting has risen from 37.1% to 42.8%. Over time, the managers aim to reduce the long tail of smaller investments, which is reflected in the reduction of portfolio holdings outside the top 80 from 22.8% at 31 December 2012 to 12.7% at 31 December 2013. Although the manager reports that average market capitalisation of companies held in the portfolio has increased significantly over the past three to four years, the fund retains a small- and mid-cap focus.

Exhibit 3: Portfolio sector weightings including fixed income allocations

	End April 2014 (%)	End April 2013 (%)	Change
Oil & Gas	37.1	27.4	9.7
Gold	15.4	20.4	-5.0
Palm Oil	11.0	8.7	2.3
Finance	6.0	5.2	0.8
Other investments	4.7	4.1	0.6
Copper	3.8	4.9	-1.1
Uranium	3.7	6.4	-2.7
Nickel	3.2	3.5	-0.3
Other mining investments	3.0	4.4	-1.4
Silver	2.4	2.1	0.3
Agriculture	2.1	1.7	0.4
Rare Earth	2.0	4.5	-2.5
Diamonds	2.0	1.0	1.0
Alternative Energy	1.5	0.7	0.8
Iron Ore	1.4	2.9	-1.5
Coal	0.3	1.1	-0.8
Steel	0.3	0.0	0.3
Platinum	0.1	0.2	-0.1
Rubber	0.0	0.8	-0.8
	100.0	**100.0**	

Source: City Natural Resources High Yield Trust, Edison Investment Research.

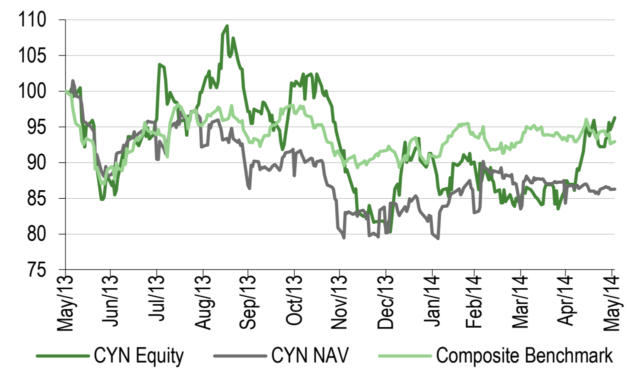
At 30 April 2014, the oil & gas sector constituted over one-third of the portfolio, having seen the greatest increase in exposure across the sectors compared with a year earlier. The increase in oil & gas exposure has more than offset the decline in gold exposure and in combination these two sectors represent 52.5% of the portfolio, compared with 47.8% at 30 April 2013. Other than oil & gas, the largest increase in exposure has been in the palm oil sector. Portfolio exposure to the palm oil sector is relatively concentrated and consists of three top 20 holdings.

Performance: Weakness during the past two years

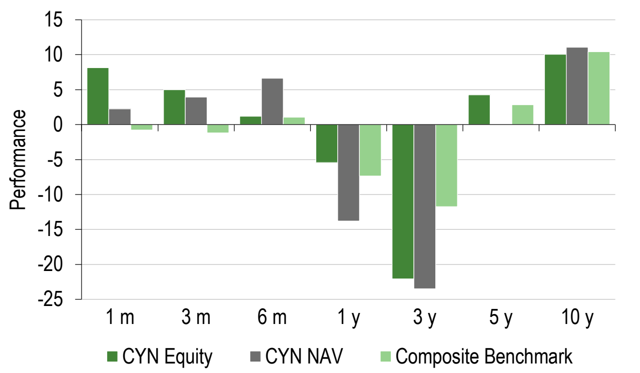
As Exhibit 4 illustrates, while CYN has underperformed the composite benchmark (weighted two-thirds to the Euromoney World Mining Index and one-third to the Credit Suisse High Yield Index) in terms of NAV total return over one, three and five years, it has outperformed over 10 years and the period since launch in August 2003. A weak relative performance from March 2012 to February 2014, which the manager attributes primarily to the overweight small and mid-cap holdings in the portfolio as well as the headwind of sterling strength against the Canadian and Australian dollars, has outweighed the strong relative performance achieved during the previous eight years. As illustrated by Exhibit 6, CYN has seen two periods of substantial outperformance from January 2006 to July 2007 and from April 2010 to March 2011which coincide with periods in which small-cap resources shares outperformed their large-cap peers. In terms of risk-adjusted returns, CYN's Sharpe ratios over one and three years are negative but not substantially different from peer group averages. Over five years CYN's Sharpe ratio of 0.2 is low but ahead of the peer group average.

Exhibit 4: Investment trust performance

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



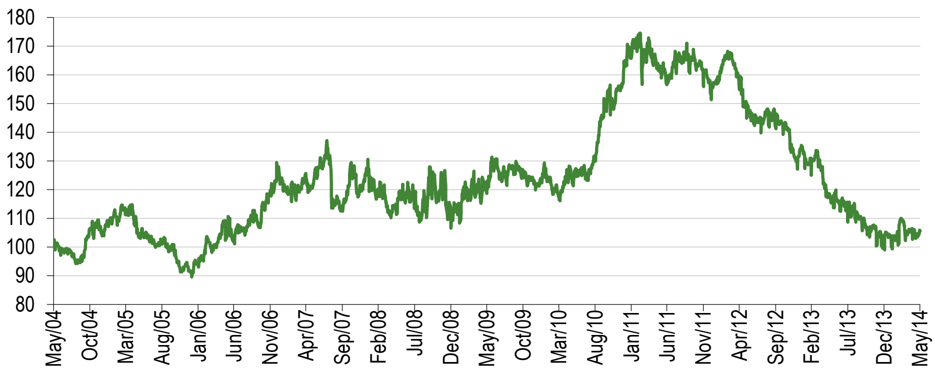
Source: Thomson Datastream, Edison Investment Research. Note: Three, five and 10-year performance figures annualised.

Exhibit 5: Share price and NAV total return performance, versus benchmarks (percentage points)

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price versus Composite Benchmark	8.9	6.2	0.1	1.9	(21.4)	8.3	(9.3)
NAV versus Composite Benchmark	3.0	5.1	5.5	(6.4)	(23.9)	(14.8)	15.8
Price versus Euromoney Global Mining	9.8	7.3	0.8	3.6	(11.1)	23.3	(16.7)
NAV versus Euromoney Global Mining	3.9	6.2	6.2	(4.7)	(13.7)	0.3	8.4
Price versus CRB Commodity	8.8	4.1	(7.3)	(3.4)	(38.5)	6.7	120.1
NAV versus CRB Commodity	2.9	3.0	(1.9)	(11.8)	(41.0)	(16.4)	145.2

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-May 2014 and indices £ adjusted.

Exhibit 6: NAV total return performance relative to benchmark over 10 years

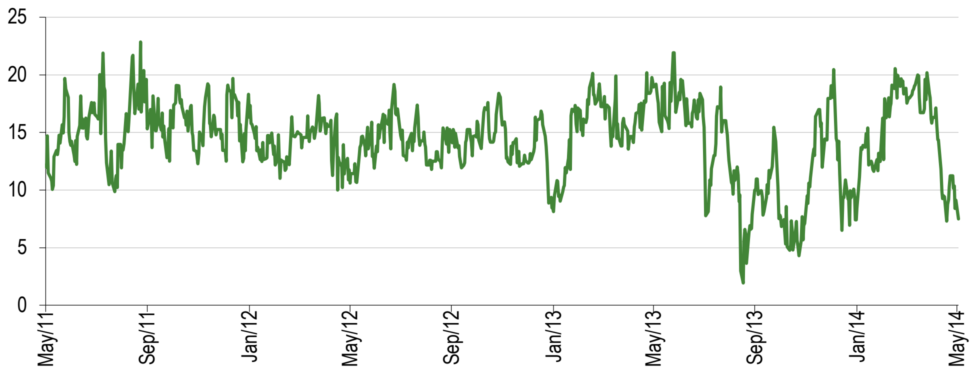


Source: Thomson Datastream, Edison Investment Research

Discount: Below the long-term average

CYN has authority to both allot and repurchase shares, although the board has not provided any commitment to maintain the discount at a particular level. Exhibit 7 illustrates that, after narrowing to 2% in September 2013, the discount widened in early 2014 to the higher end of its three-year range before narrowing again sharply, perhaps reflecting changing sentiment towards growth in China. The current 9% discount stands below the 14% three-year average but above the 2% low.

Exhibit 7: Discount over three years (%)



Source: Morningstar, Edison Investment Research. Note: Positive values indicate a discount.

Capital structure and fees

CYN has 66.9m ordinary shares and £39.9m nominal of 3.5% Convertible Unsecured Loan Stock 2018 (CULS) in issue. Interest on the CULS is payable semi-annually on 31 March and 30 September and they may be converted into ordinary shares on 31 March and 30 September in each year at a conversion price of 377.2p nominal per share.

Structural gearing is provided by the CULS and CYN has not held any bank debt since September 2011. Net gearing is limited to 25% of net assets and has generally been maintained in the range of 20% to 25% since the CULS were issued. Net gearing is managed through the level of cash held. As at 31 March 2014, CYN held £17.4m cash with 35% gross gearing and 19% net gearing. The managers do not anticipate any significant change from current gearing levels.

CYN pays a monthly management fee of 0.1% of net assets, equating to 1.19% per year. The valuations of holdings in New City Energy and Golden Prospect Precious Metals (also managed by NCIM) are deducted from assets when calculating the management fee. CYN pays no performance fee and the management contract can be terminated at three months' notice by either party.

Dividend policy

CYN aims to maintain or increase the total dividend paid for each financial year. Income and dividends have been a constant focus since the first dividend was paid in 2004, since when it has been maintained or increased every year. CYN pays quarterly dividends with three equal interim payments usually followed by a larger final payment. It paid a total dividend of 5.5p for the year to June 2013, the sixth successive year of double-digit increases. The first three interim dividends in FY14 have been maintained at the same level as in FY13 and the managers have indicated that double-digit dividend growth will not be targeted ahead of CYN's capital growth objective.

Peer group comparison

Exhibit 8 illustrates a closed-ended peer group comparison across the commodities and natural resources sector. We use the AIC specialist commodities and natural resources sector constituents excluding CEB Resources (which distorts the averages) as the peer group. CYN's NAV total return over one year is similar to the peer group average and, while at the lower end of the peer group range over three years, over five years it ranks ahead of the median and over 10 years it ranks as the top performer, slightly ahead of BlackRock's World Mining Trust. Its ongoing charge of 1.47% compares favourably to the majority of peers, six of which have charges of more than double this rate. CYN is one of only five dividend-paying trusts in the peer group.

Exhibit 8: Funds investing in resources equities: Total returns, Sharpe ratios and discounts

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 Year	NAV TR 10 year	Discount (ex par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield (%)
City Natural Resources Ord	95.0	(14.3)	(54.5)	(1.1)	194.4	(9.1)	1.47	No	125	3.9
Altus Resource Capital Ord	28.0	(13.1)	(61.7)			(13.3)	2.47	Yes	92	
Baker Steel Resources Ord	27.0	(38.9)	(51.1)			(23.8)	2.17	Yes	101	
BlackRock Commodities Income Ord	112.6	1.9	(12.9)	37.0		3.0	1.39	No	107	5.4
BlackRock World Mining Trust Ord	819.6	(9.2)	(42.4)	9.8	183.2	(1.2)	1.37	No	115	4.5
El Oro Ord	47.1	8.4	(34.4)	15.5		(29.5)	1.70	Yes	144	4.9
Geiger Counter Ord	19.8	(16.9)	(70.3)	(46.3)		(9.8)	2.96	Yes	101	
Global Resources Ord	23.7					(11.7)		Yes	113	
Golden Prospect Precious Metal Ord	20.0	(22.9)	(62.9)	(7.2)		(17.9)	2.37	Yes	101	
International Oil & Gas Techno Ord	6.7	(55.8)	(58.3)	(57.0)		(65.9)	4.44	Yes	97	
New City Energy Ord	18.8	3.5	(35.7)	26.5		(26.7)	3.35	Yes	101	5.5
Praetorian Resources Ord	4.1	(2.3)				(57.8)	3.62	Yes	117	
RAB Special Situations Ord	6.1	(12.1)	(49.9)	(56.3)		(48.0)	4.31	Yes	96	
Riverstone Energy Ord	627.2					(7.7)	0.67	Yes	8	
Tiger Resource Finance Ord	2.2	(19.9)	(51.4)	(38.1)	(3.9)	(19.0)	17.48	No	54	
Simple average		**(14.7)**	**(48.8)**	**(11.7)**	**124.6**	**(22.6)**	**3.56**		**98**	**4.9**
Weighted average		**(9.1)**	**(41.8)**	**10.0**	**183.9**	**(6.0)**	**1.27**		**78**	**2.7**

Source: Morningstar 3 June 2014. Note: TR = total returns, TER = total expense ratio. The Sharpe ratio is a measure of risk-adjusted return. The ratios we show are calculated by Morningstar for the past 36-month period by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash/cash equivalents as percentage of shareholders' funds.

The board

Following Adam Cooke standing down at the December 2013 AGM, the board consists of four independent non-executive directors. Chairman Geoffrey Burns (appointed July 2005) has worked in the investment fund industry for over 25 years and is also chairman of Premier Energy and Water Trust. Adrian Collins (appointed December 1995) has worked in the fund management business for over 35 years. He is chairman of Liontrust Asset Management and Bahamas Petroleum Company and is a director of New City High Yield Fund, also managed by NCIM. Michael Coulson (appointed June 2003) is a senior research analyst covering mining and gold shares with more than 38 years' experience. Richard Prickett (appointed November 2006) is a Chartered Accountant with substantial corporate experience in the mineral sector. He is a director of Landore Resources and non-executive chairman of Asian Growth Properties.

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