

15 November 2011

## City Natural Resources High Yield Trust

12 Months Ending	Total Share Return* (%)	Total NAV Return* (%)	Total Return Composite B'mark* (%)	Total Return HSBC Gbl Mining* (%)	Total Return FTSE World Index* (%)
10/11/08	(53.1)	(45.8)	(41.6)	(47.4)	(20.3)
10/11/09	91.4	87.4	72.3	82.5	22.4
10/11/10	68.9	57.0	32.6	34.1	16.3
10/11/11	(9.4)	(3.4)	(11.3)	(14.1)	(3.4)

Note: \*12 month rolling discrete performance.

### Investment summary: Well diversified natural resources exposure

City Natural Resources High Yield Trust (CYN) is one of only three UK-registered investment trusts to focus exclusively on the natural resources sector. It has a strong long-term performance record in a well performing sector. Returns in the sector are more focused on capital growth than yield, but CYN pays quarterly dividends and for the year ending 30 June 2011 paid a total dividend of 4.22p, which has more than doubled in the last four years. The manager remains very bullish on the long-term outlook for the natural resources sector amid slowing but continued global economic growth and, in September 2011, CYN issued £40m of convertible unsecured loan stock to provide fixed gearing, at 3.5%, to 2018.

### Investment strategy: Diversified natural resources exposure

CYN is a global fund that invests in the debt and equity securities of mostly quoted companies in the mining and natural resources sectors and supporting industries. It is managed using a mixture of top-down and bottom-up strategies and maintains an extensively diversified portfolio of about 200 securities. Gearing is employed with a view to enhance returns over the longer term. Currently, gross gearing is 16.1%, attractively fixed at 3.5%.

### Sector outlook: Long-term positive for natural resources

Despite a potential global economic slowdown, the manager remains very positive on the long-term outlook for the natural resources sector, particularly for the production end, given what the manager views as the difference between increasing demands and the reducing supplies of natural resources. The sector is not immune to the effects of a global slowdown. However, commodities and natural resources have enjoyed significant demand from emerging economies whose growth has held up comparatively well. The manager believes dividends will be an increasingly important component of return from natural resource securities.

### Valuation: Discount above five-year average

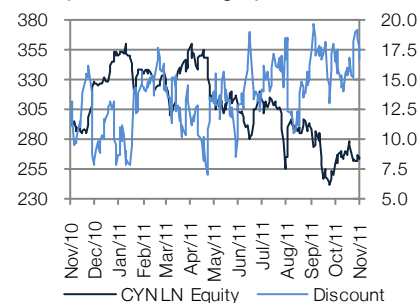
The discount, at 15.9%, is below its three-year average of 17.8% and above its five-year average of 14.2%. As such, we believe the trust offers value, particularly to investors looking for a diversified global natural resources exposure, with the potential for dividend growth.

Price	270.0p
Market Cap	£180.5m
AUM	£251.5m
NAV	321.04p*
Discount to NAV	15.9%*
NAV	321.38p**
Discount to NAV	16.0%**
Yield	1.6%

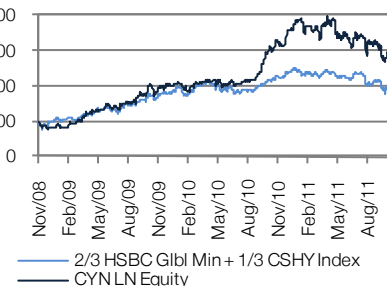
\* Adjusted for debt at market value, excluding income, as at 9 November 2011.

\*\* Adjusted for debt at market value, including income, as at 9 November 2011.

#### Share price/discount graph



#### 3-year cumulative performance graph



#### Share details

Code	CYN
Listing	FULL
AIC Sector	N/A
Shares in issue	66.9m

#### Price

52 week	High	Low
Price	360.13p	241.00p
NAV	405.92p	277.28p

#### Analyst

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**Exhibit 1: Trust at a glance**

Investment objective and fund background				Developments last quarter	
City Natural Resources High Yield Trust's investment objective is to provide shareholders with capital growth and income from a portfolio of mining and resource equities, resources and industrial fixed interest securities.				14 October 2011: Annual report for the year ending 30 June 2011 released. 23 September 2011: General Meeting – Resolution regarding the placing and open offer of £40m of Convertible Unsecured Loan stock passed.	
Forthcoming		Capital structure		Fund details	
AGM	December 2011	Total expense ratio	1.50%	Group	New City Investment Managers
Results	September 2012	Net gearing	8.6%	Manager	Will Smith and Ian Francis
Year end	30 June	Annual mgmt fee	See pg 7	Address	New City Investment Managers, 5th Floor, 33 Chester Street, London SW1X 7LB
Dividend paid	Quarterly	Performance fee	None		
Launch date	1994	Trust life	Indefinite	Phone	+44 (0)20 7201 6900
Wind-up date	See pg 7	Loan facilities	See pg 7	Website	www.ncim.co.uk
Dividend policy and history			Share buyback policy and history		
Quarterly dividends paid in November, February, May and August. CYN is managed with a view to progressing the total dividend in respect of each financial year.			Renewed annually, the trust has authority to purchase up to 14.99%, and allot up to 9.99% of issued share capital.		
<p>DPS (p)</p> <p>2002 2003 2004 2005 2006 2007 2008 2009 2010 2011</p> <p>■ Ordinary Dividends ■ Special Dividends</p>			<p>No. of shares ('000s)</p> <p>Cost/proceeds (£m)</p> <p>Nov/10 Dec/10 Jan/11 Feb/11 Mar/11 Apr/11 May/11 Jun/11 Jul/11 Aug/11 Sep/11 Oct/11</p> <p>■ Repurchases ■ Allotments — Total cost - - - Total proceeds</p>		
Shareholder base (as at 31 October 2011)			Geographic distribution of portfolio* (as at 31 October 2011)		
<p>■ Henderson Global (5.8%) ■ Reliance Mutual (4.9%) ■ Jupiter Asset Mgmt (4.9%) ■ SVM Asset Mgmt (4.1%) ■ Rathbone Inv Mgmt (4.0%) ■ West Yorks PF (4.0%) ■ South Yorks Pension (4.0%) ■ Brewin Dolphin (3.6%) ■ L&amp;G Inv Mgmt (3.6%) ■ K&amp;K Stockbrokers (3.1%) ■ Other (58.0%)</p>			<p>■ Australia (35.3%) ■ Canada (28.5%) ■ UK (19.6%) ■ US (8.2%) ■ Europe (2.2%) ■ Norway (0.7%) ■ South Africa (0.3%) ■ Papua New Guinea (0.1%) ■ Unquoted (5.0%)</p> <p>*by stock market quotation</p>		
Portfolio composition (as at 31 October 2011)			Portfolio composition (as at 30 April 2011)		
<p>■ Kalahari Minerals (3.7%) ■ Extract Resources (3.2%) ■ Rea Holdings (3.1%) ■ Ausgold (3.0%) ■ New Britain Palm Oil (2.8%) ■ Neo Material Tech (2.1%) ■ Silver Lake Resources (2.0%) ■ Perseus Mining (2.0%) ■ Silver Wheaton (1.8%) ■ Rockgate Capital (1.6%) ■ Other (68.2%) ■ Cash (6.5%)</p>			<p>■ Kalahari Minerals (3.6%) ■ Ausgold (3.3%) ■ Extract Resources (3.2%) ■ New Britain Palm Oil (2.7%) ■ Rea Holdings (2.7%) ■ Perseus Mining (1.7%) ■ Neo Material Tech (1.6%) ■ Coalspur Mines (1.6%) ■ Great Western Minerals (1.5%) ■ Polar Star Mining (1.5%) ■ Other (76.4%) ■ Cash (0.2%)</p>		

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

## Exhibit 2: Top five holdings at a glance

Kalahari Minerals		Code: KAH LN	Market cap: £564.2m
		Div Yield (trailing 12 mths)	N/A
		Industry/Sector	Ind. Metals & Mining/Nonferrous
		Listing	UK – AIM
		Website	<a href="http://www.kalahari-minerals.com">www.kalahari-minerals.com</a>
		<p>Kalahari Minerals' (KAH) key value drivers are its 40% holding in Extract Resources and its c 45% holding in North River Resources. It has been in discussions with Extract to facilitate combining Extract's Husab project with Rio Tinto's Rössing South. Kalahari is also in discussions with China Guangdong Nuclear Power Group – Uranium Resources Company (CGNPG-URC) about a possible takeover of Kalahari.</p>	
Extract Resources		Code: EXT AU	Market cap: A\$1,984.2m
		Div Yield (trailing 12 mths)	N/A
		Industry/Sector	Diversified Minerals
		Listing	Australia – ASX
		Website	<a href="http://www.extractresources.com">www.extractresources.com</a>
		<p>Extract Resources' (EXT) primary focus is its Husab Uranium project in Namibia, which is believed to be the world's largest undeveloped uranium deposit. EXT's major shareholder, Kalahari Minerals (see above) is in takeover discussions. This is seen as a precursor to acquiring EXT itself. The manager considers that the proximity of Husab to Rio Tinto's Rössing South Mine makes Rio a natural acquirer and so expects a counter move in due course.</p>	
Rea Holdings		Code: RE. LN	Market cap: £190.5m
		Div Yield (trailing 12 mths)	1.01%
		Industry/Sector	Food Producers/Farming & Fishing
		Listing	UK – FULL
		Website	<a href="http://www.rea.co.uk">www.rea.co.uk</a>
		<p>Headquartered in London, Rea's principal activities are cultivating oil palms and producing crude palm oil and crude palm kernel oil, in the Indonesian province of East Kalimantan. The company operates two oil mills and a fleet of barges for transporting its end products. The manager considers that Rea is well managed and continues to impress and that an increasing oil price will have a positive effect on palm oil demand.</p>	
Ausgold		Code: AUC AU	Market cap: A\$137.3m
		Div Yield (trailing 12 mths)	N/A
		Industry/Sector	Gold Mining
		Listing	Australia – ASX
		Website	<a href="http://www.ausgoldlimited.com">www.ausgoldlimited.com</a>
		<p>Ausgold (AUC) is a small gold producer in Western Australia. Although still at an early stage, drilling results at its Boddington South site have been very encouraging. AUC's current size in CYN's portfolio is a result of appreciation reflecting these developments. The manager considers that the proximity of AUC's Boddington development to Newmont's may make Newmont a natural buyer.</p>	
New Britain Palm Oil		Code: NBPO LN	Market cap: £1,194.5m
		Div Yield (trailing 12 mths)	1.18%
		Industry/Sector	Food Producers/Farming & Fishing
		Listing	UK – FULL
		Website	<a href="http://www.nbpol.com.pg">www.nbpol.com.pg</a>
		<p>New Britain Palm Oil (NBPO) is Papua New Guinea's largest oil palm plantation and milling operator. The company's primary focus is the cultivation and processing of oil palm into crude palm oil, palm kernel oil and palm kernel expeller, which it sells to the UK, Europe and Australia. The manager considers that NBPO is very well managed and is located in a very good jurisdiction. The holding reflects his view on the sector.</p>	

Source: Bloomberg/Thomson Datastream, Edison Investment Research

## Fund profile

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CYN is one of only three UK-registered investment trusts to focus exclusively on the natural resources sector. Following an EGM in June 2003, the trust underwent a major reorganisation, which saw a complete change of investment focus, a change of investment manager and the introduction of an income component in the form of quarterly dividends. Richard Lockwood led the management of CYN after the trust's reorganisation in 2003 and, in March 2008, was joined by Will Smith as co-manager. September 2010 saw Richard Lockwood step down as a primary manager and move into an advisory role. Merfyn Roberts joined Will Smith as a co-manager but, following his recent resignation, Will has been joined by Ian Francis, another long-time member of the New City team, as co-manager of the trust. Ian will focus on the fixed income side of the portfolio.

Reflecting its investment mandate, CYN has a composite benchmark index that comprises two-thirds HSBC Global Mining Index and one-third Credit Suisse High Yield Index. Both components are sterling adjusted and performance is evaluated on a total-return basis using a base date of 1 August 2003, the date when the transition to the natural resources portfolio was considered complete. Using this measure CYN has, since 1 August 2003, outperformed its composite benchmark index by 327.6% in terms of NAV total return and 215.2% in terms of share price total return. In September 2011 CYN issued £40m of 3.5% Convertible Unsecured Loan Stock (CULS). The CULS has a fixed seven-year life until 2018 and interest payments are made semi-annually on 31 March and 30 September each year. The conversion price is 377.2p, which is a 10% premium to CYN's NAV as at 20 September 2011.

## The fund managers: Will Smith and Ian Francis

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### Manager's view

Despite current market difficulties, the manager remains very bullish on the long-term outlook for the sector. The key themes currently employed in managing the portfolio are:

- The longer-term demand picture for natural resources is positive. Emerging economies like China, India and Brazil are driving global economic growth (the IMF recently forecast world output at around 4.0% for this year and next) despite weakness in the US and Europe.
- In the very long run, resource pricing is driven by the cost of production and, in general, cheaper-to-extract natural resource deposits have already been exploited. The manager believes that the market frequently fails to appreciate the cost of new development.
- With the exception of Kazakhstan, Russia and Emerging Russia are difficult investment environments. The assets exist but political situations are unstable and, given the size of the investment universe, there is not a case for taking the risk in the portfolio.
- The outlook for base metals remains positive and is expected to be driven by demand from the large industrialising emerging markets such as China, India and Brazil.
- Palm oil, particularly sustainable palm oil, is an area with strong growth potential.
- The manager continues to like uranium and considers that, while Fukushima has disrupted uranium's progression, nuclear power will still be crucial to maintaining a secure energy supply in an increasingly carbon-conscious world. The manager expects uranium

demand to exceed supply once the US-Russian HEU Agreement comes to an end in 2013, and expects to see consolidation in the uranium space.

- Rare earths, typically used in manufacturing electrical components, are expected to see continued strong demand from the Far East, particularly Japan. At present, China controls c 95% of existing output.
- The portfolio will remain overweight until there is a return to positive real interest rates as well as a return to growth in OECD countries, and until the sovereign debt crisis is resolved.
- The manager invests in companies whose management teams are “sensible stewards of the business and shareholder capital”. The manager prefers companies that avoid equity dilution and are prepared to use debt financing as an alternative.
- The manager favours companies that have solid balance sheets, offer growth potential and have a strong capacity to pay dividends.
- The manager considers that virtually all income and assets are overseas based, ie the trust represents a strong play for those looking to diversify outside the pound.

## Asset allocation

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### Investment process

CYN is managed using a mixture of top-down and bottom-up investment strategies. The process begins with the identification of sectors and geographical areas that the manager favours, to varying degrees. This serves as a guide to the evolution of the portfolio. However, the portfolio is not managed with specific reference to geographic or sector allocation targets or with reference to those of the underlying benchmark. Instead, the New City team focuses its efforts on the fundamental analysis of investment opportunities, meeting, on average, 20 companies a week. Once included in the portfolio, the team continues to assess stocks, on an ongoing basis, to ascertain whether the level of holding remains appropriate. It is the trust’s policy not to attempt to hedge currency exposure, so CYN is exposed to currency risk. However, this is to a certain extent mitigated by the number and spread of holdings in the portfolio.

### Overview

CYN has 187 holdings in its portfolio. The top 10 holdings account for 25.3% of the portfolio. Exhibit 3 illustrates CYN’s sector allocations as at 31 October 2011. The significant gold allocation reflects the manager’s views on the sector.

**Exhibit 3: Sector allocations, as at 31 October 2011**

	Trust Weight (%)
Gold & precious metals	37.3
Energy	19.1
Uranium	12.1
Base metals	9.9
Soft commodities	8.6
Rare earths	7.7
Other	5.3
<b>Total</b>	<b>100</b>

Source: City Natural Resources High Yield Trust

## Top holdings

During the 12 months to 10 November 2011, the composite benchmark index has fallen 11.2%. As Exhibit 4 shows, eight out of CYN's top 10 holdings have outperformed the index during this period.

### Exhibit 4: 10 largest equity holdings as at 31 October 2011

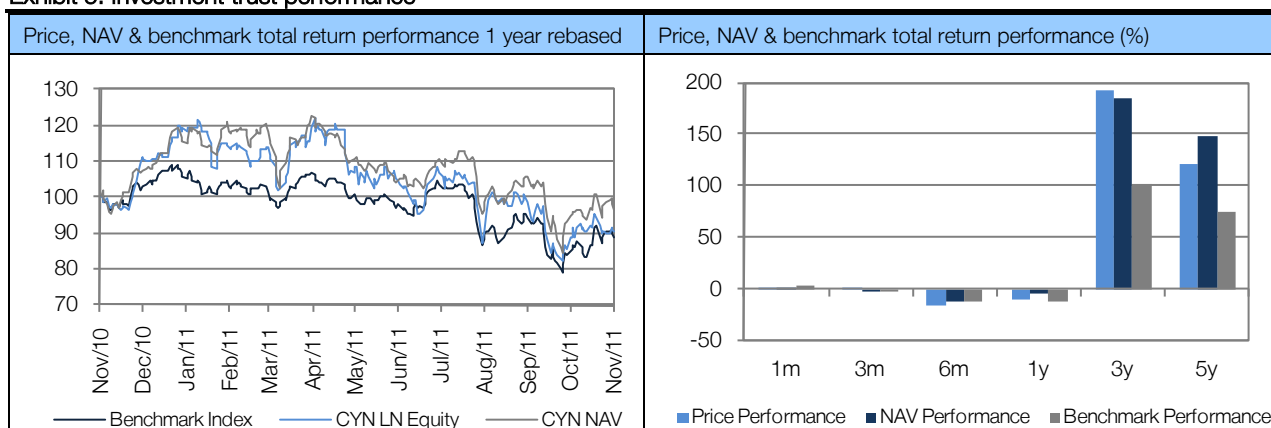
Note: Benchmark Index 2/3 HSBC Global Mining Index and 1/3 Credit Suisse High Yield Index (Sterling Adjusted) one-year performance to 1 November 2011 was -11.2%.

Holding	%	One year total return price performance (%)	Performance relative to Composite Index (%)
Kalahari Minerals	3.7	10.6	21.8
Extract Resources	3.2	(7.3)	3.9
Rea Holdings	3.1	(17.8)	(6.6)
Ausgold	3.0	183.6	194.8
New Britain Palm Oil	2.8	(2.3)	9.0
Neo Material Technologies	2.1	40.9	52.1
Silver Lake Resources	2.0	67.3	78.6
Perseus Mining	2.0	5.9	17.2
Silver Wheaton	1.8	2.2	13.4
Rockgate Capital	1.6	(31.4)	(20.2)
<b>Total</b>	<b>25.3</b>		

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

## Recent performance

### Exhibit 5: Investment trust performance



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

### Exhibit 6: Share price and NAV total return performance (sterling adjusted), relative to benchmarks

Note: \*NCIM measurement period is from 1 August 2009 when NCIM considers portfolio adjustments, following NCIM's appointment as manager on 26 June 2003, were complete.

	1 month	3 months	6 months	1 year	3 years	5 years	NCIM
Price relative to Benchmark Index	(2.6)	1.3	(4.2)	1.9	90.1	45.2	215.2
NAV relative to Benchmark Index	(2.4)	(1.0)	(0.6)	7.8	81.5	73.1	327.6
Price relative to HSBC Global Mining	(2.5)	1.7	(1.8)	4.7	82.5	44.3	125.7
NAV relative to HSBC Global Mining	(2.3)	(0.6)	1.9	10.7	73.9	72.2	238.2
Price relative to FTSE World Index	0.9	(6.0)	(5.8)	(6.0)	155.3	104.3	417.7
NAV relative to FTSE World Index	1.1	(8.3)	(2.2)	(0.0)	146.7	132.2	530.1
Price relative to FTSE All-Share Index	0.7	(8.4)	(7.6)	(6.0)	151.3	115.4	407.8
NAV relative to FTSE All-Share Index	0.9	(10.7)	(4.0)	(0.0)	142.7	143.3	520.3

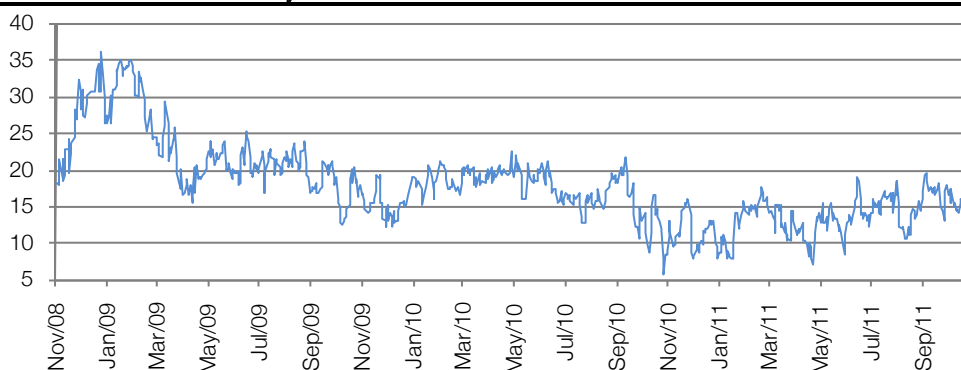
Source: Thomson Datastream, Edison Investment Research

As Exhibits 5 and 6 illustrate, CYN has outperformed its composite benchmark, the HSBC Global Mining Index and the FTSE World Index, in terms of both share price and NAV total return, over three five years and since New City has managed the trust.

## Discount

CYN has the authority, renewed annually, to allot up to 9.99% or make market purchases of up to 14.99% of issued share capital, which provides the manager with a mechanism to influence the discount. However, despite this authority, the trust does not have an explicit discount maintenance policy and has not, to date, undertaken any repurchases of its shares, as illustrated in Exhibit 1. Furthermore, with the exception of shares issued in relation to warrant exercise in November 2006, 2007, 2008 and 2009, there has been no change in issued share capital since October 2003 when 42.9m shares were issued as part of the trust's reorganisation. Exhibit 7 shows the discount of the trust over the past three years. CYN's discount increased substantially following the financial crisis, and reached its five-year high of 36.1% in January 2009, before tightening substantially between February and May 2009. Since May 2009 the discount has broadly followed a path of gradual tightening. At 15.9% the discount is below its three-year average of 17.8% and above its five-year average of 14.2%.

**Exhibit 7: Discount over three years**



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

## Capital structure

CYN is a conventional investment trust with only one class of equity share in issue – 25p ords. The trust is able to gear up to 25% of the shareholders' funds, which gives CYN flexibility in choosing its gearing policy. As at 31 October 2011, CYN had gross gearing of 16.1% and net gearing of 8.6%. All current gearing is provided by CYN's newly issued CULS. The management fee is calculated monthly as 0.1% of the company's net assets (excluding any borrowings), payable in arrears, which is equivalent to 1.19% per year. There is no performance fee and the management contract can be terminated at 12 months' notice by either side. The total expense ratio (TER) was 1.50% for the year ended 30 June 2011 (1.50% for the year ended 30 June 2010). Although CYN does not have a fixed life, a resolution to allow the company to continue in existence as an investment trust is put to shareholders at each AGM. If the continuation vote is not passed, the board will put forward proposals to liquidate, open end or otherwise reconstruct the company.

## Dividend policy and record

CYN pays quarterly dividends. The first interim dividend is paid in November (2011 = 0.77p, 2010 = 0.69p), which establishes the level for the second and third interims in February and May respectively. This is followed by a larger final dividend in August (2011 = 2.15p, 2010 = 1.85p). For

the year ending 30 June 2011 CYN paid a total dividend of 4.22p (2010 = 3.71p). Following the 2003 organisation, there was no explicit commitment to grow the dividend and the trust aimed to at least maintain the dividend for each financial year. However, for a number of years CYN has been managed with a view to enhancing income within the portfolio, and progressing the dividend. As a reflection of this, since CYN began paying ordinary dividends in 2004, the trust has maintained or increased its dividend every year, as is illustrated in Exhibit 1. During this six-year period the trust has increased its dividend by 111.0%. This is an average increase of 11.4% per year, or 11.3% per year annualised, which is well above the rate of inflation. Between 2010 and 2011 the total dividend has increased by 13.7% year-on-year, which is above the long-term growth rate. The manager and board have indicated that they remain confident CYN can provide double-digit dividend growth over the next two years. As at 30 June 2011, CYN had revenue reserves equal to 6.8p per share (2010 = 5.7p). Management fees and interest payable are charged 25% and 75% to the revenue and capital accounts, respectively. This allocation reflects the board's view as to the long-term distribution of portfolio returns.

## Peer group comparison

Exhibit 8 illustrates a closed-end peer group comparison across the commodities and natural resources sector. There are 22 constituents (a sample is given). However, the investment focuses can vary markedly. Within this group, CYN ranks 11<sup>th</sup> over one year, second over three years and first over five years when considering share price total return. It ranks ninth over one year, second over three years and first over five years when considering NAV total return.

**Exhibit 8: Closed-ended commodities and natural resources peers, as at 11 November 2011**

Company	Price performance			NAV performance		
	One year	Three year	Five year	One year	Three year	Five year
City Natural Resources High Yield Trust	(9.4)	192.8	120.7	(3.8)	183.2	147.7
BlackRock Commodities Income	(7.9)	75.5	57.2	(6.1)	78.7	53.1
BNP Energy Base Metals	(10.8)	140.0	52.1	(10.7)	139.3	63.3
BlackRock World Mining	(20.1)	32.5	31.3	(16.1)	36.1	47.3
Close Enhanced Commodities II	(14.8)	39.0	N/A	35.9	7.9	N/A
Golden Prospect Precious Metals	14.9	335.8	N/A	10.6	396.8	N/A

Source: Thomson Datastream, Bloomberg, Edison Investment Research

## The board

All directors are non-executive and, with the exception of Adam Cooke, are independent of the investment manager. They are Geoffrey Burns (chairman), Adrian Collins, Adam Cooke, Michael Coulson and Richard O Prickett (directors). The average length of service is 8.9 years.

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