

City Natural Resources High Yield Trust

Sector play with discount and yield

City Natural Resources High Yield Trust (CYN) provides actively managed diversified exposure to the natural resources sector with a particular focus on income. A broad decline in commodity prices accounts for the negative performance of CYN and its peers over the last few years, although 2014 saw an easing of the downtrend despite the fall in the oil price. Signs that lower prices will feed through to lower supply raise the prospect of a more favourable balance in many commodity markets. Meanwhile, CYN offers a yield of over 5% and is trading at the top of its recent discount range.

12 months ending	Total share price return (%)	Total NAV return (%)	Composite Benchmark (%)	Euromoney Global Mining (%)	CRB Commodity (%)
31/12/11	(28.2)	(27.5)	(22.3)	(27.0)	(7.5)
31/12/12	(13.1)	(17.3)	(0.0)	(2.4)	(7.5)
31/12/13	(39.8)	(35.8)	(17.8)	(24.1)	(6.7)
31/12/14	(12.1)	(8.4)	(7.3)	(13.0)	(12.8)

Note: Twelve-month rolling discrete total return performance.

Investment strategy: Diversified resources exposure

CYN's investment objective is to provide capital growth and income through investing predominantly in natural resources equities and also resources and industrial fixed interest securities. It maintains a diversified exposure across oil & gas, mining and agricultural commodities, with a bias to small- and mid-cap stocks. While CYN is structurally geared through convertible debt and net gearing is generally maintained between 20% and 25%, this is broadly matched by investments in fixed income securities (c 30% currently), which support the income element of the mandate. Investments are primarily based on bottom-up stock selection, drawing on the managers' industry experience, meetings with management and valuation analysis. This is supported by a top-down overlay, which provides broader commodity and geographic preferences.

Sector outlook: Low prices promote supply discipline

Lower profitability due to a combination of falling commodity prices and cost inflation over the last four years has resulted in mining companies cutting development expenditure and the recent fall in the oil price appears likely to see a similar reaction by the oil industry. This should improve commodity market fundamentals through reducing potential oversupply in the medium term. Declines across the commodities spectrum last year mean that prices in general are reflecting markets in surplus, which provides scope for prices to move higher as demand rises in the medium term and commodity markets move into deficit. Commodity producers' current focus on maximising profitability means that corporate earnings could see a significant uplift as commodity prices rise.

Valuation: Discount at higher end of historical range

Over the last 12 months the discount has ranged from 6% to 23% and currently stands at the higher end of this range, suggesting scope for a significant narrowing once sentiment towards the resources sector improves. Dividends have been held steady or increased in each financial year since 2004 and CYN's 5.5% yield is supported by 1.7 years of revenue reserves.

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

Investment trusts

22 January 2015

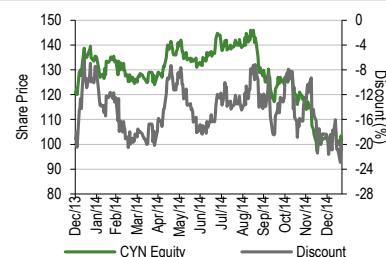
Price 101.8p
Market cap £68m
AUM £125.8m

NAV* 127.6p
Discount to NAV 20.2%
NAV** 128.6p
Discount to NAV 20.9%

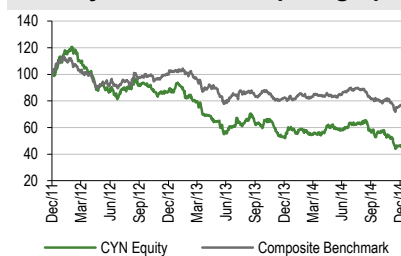
*Adjusted for debt at market value, excluding income.
**Adjusted for debt at market value, including income.

Yield 5.5%
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 146.0p 97.0p
NAV* high/low 165.3p 120.5p

*Including income.

Gearing

Gross* 43.7%
Net* 21.9%

*As at 31 December 2014.

Analysts

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Exhibit 1: Trust at a glance
Investment objective and fund background

City Natural Resources High Yield Trust'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.

Recent developments

- 22 January 2015: 0.86p second quarterly dividend announced for FY15.
- 23 October 2014: 0.86p first quarterly dividend announced for FY15.
- 29 September 2014: Full year results to 30 June 2014 – NAV total return +1.4%; benchmark +6.0%.
- 29 September 2014: Alun Evans appointed as a director.

Forthcoming

AGM	November 2015
Interim results	February 2015
Year end	30 June
Dividend paid	Nov, Feb, May, Aug
Launch date	August 2003
Continuation vote	Annually

Capital structure

Ongoing charges	1.70%
Net gearing	21.9%
Annual mgmt fee	1.2% of net assets
Performance fee	None
Trust life	Indefinite
Loan facilities	None – geared using CULS

Fund details

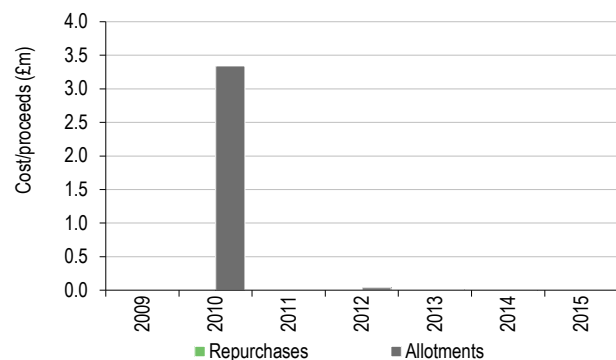
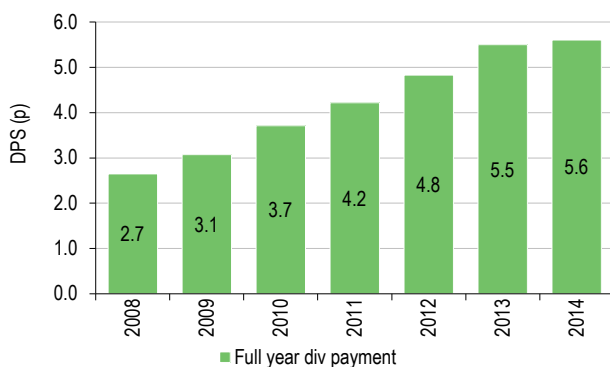
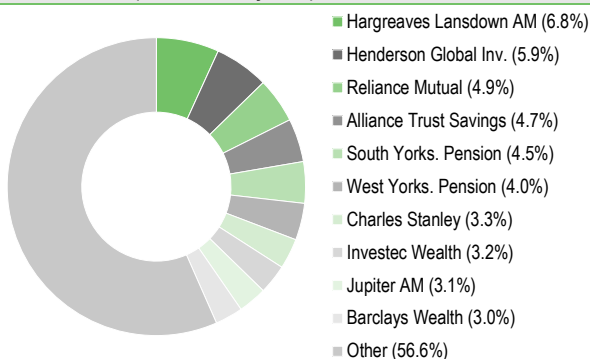
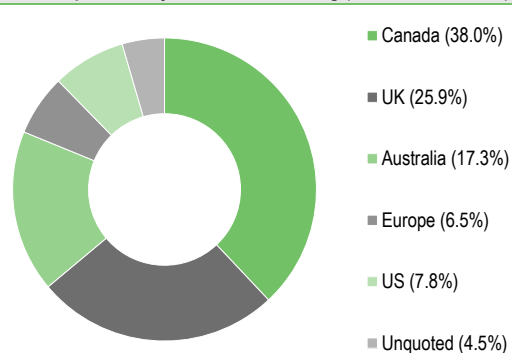
Group	New City Investment Managers
Managers	Will Smith, Ian Francis
Address	5th Floor, 33 Chester Street, London SW1X 7BL UK
Phone	+44 (0)20 7201 6900
Website	www.ncim.co.uk

Dividend policy and history

CYN pays dividends quarterly and aims to at least maintain the level of dividends in 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 to allot up to 14.99% of its ordinary shares.


Shareholder base (as at 5 January 2015)

Distribution of portfolio by stock market listing (as at 30 June 2014)

Top 10 holdings (as at 31 December 2014)

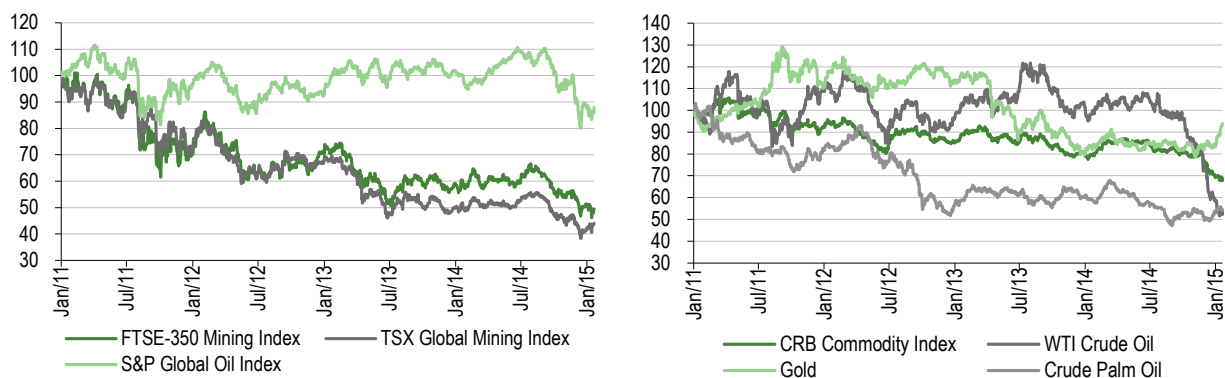
Company	Country	Commodity	Portfolio weight %	
			31 December 2014	31 December 2013
REA Holdings	UK	Palm Oil	6.8	6.4
Vermilion Energy	Canada	Oil & Gas	4.7	3.8
New Britain Palm Oil	UK	Palm Oil	4.4	3.7
APA Group	Australia	Oil & Gas	3.1	1.4
Sirius Resources	Australia	Nickel	3.0	2.4
Plant Impact	UK	Agriculture	2.9	0.9
Iona Energy 9.5% 2018	Canada	Oil & Gas	2.4	1.2
Sandfire Resources	Australia	Copper	2.2	1.7
Antares Energy 10% 2023	Australia	Oil & Gas	2.1	1.6
ARC Resources	Canada	Oil & Gas	2.1	2.1
Top 10			33.7	25.2

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

Market outlook: Lower prices driving supply discipline

Exhibit 2 illustrates the general downtrend in commodity prices over the last four years reflected by the 35% decline in the CRB Commodity index (which constitutes a broad commodity basket weighted 39% energy, 13% industrial metals, 7% precious metals and 41% agriculture) between April 2011 and December 2014. The recent correction in oil & gas equities is mirrored by a further fall in mining equities despite a lower oil price being generally favourable for mining company costs. Following its earlier weakness, the gold price has displayed relative stability similar to the majority of industrial metals. Mining companies in general responded to lower commodity prices by reducing capital expenditure and focusing on improving profitability by cutting costs and curtailing production at higher cost operations. While cost-cutting benefits mining company earnings in the near term, lower development spending reduces potential market supply, which should be positive for the medium-term outlook. The oil price fall seems likely to elicit a similar response from the oil industry.

Exhibit 2: Resources equity indices and commodity prices over four years, £-adjusted and rebased



Source: Bloomberg, Edison Investment Research

While recently reduced expectations for global GDP growth, particularly in China, have raised concerns over the outlook for commodities demand, global economic activity is still forecast to strengthen, which should translate into rising real commodity demand in the medium term. The majority of base metals, precious metals and bulk commodities have seen substantial price falls over the last few years and the combination of rising demand and constrained supply sets the foundations for the next upturn in the commodity price cycle. Commodity producers' current focus on maximising profitability means that corporate earnings could see a significant uplift as commodity prices rise. Although macroeconomic uncertainties remain and potential further economic slowdown in China could have a marked effect on global commodities demand, declines across the commodities spectrum during 2014 have left prices in general already reflecting markets in surplus and, with a more balanced medium-term supply demand outlook, scope appears to be increasing for commodity markets to move into deficit, which should support prices moving higher.

Fund profile: Diversified natural resources exposure

Launched in August 2003, CYN's 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 Global Mining Index and one-third to the Credit Suisse High Yield Index (both sterling adjusted). CYN has been managed since April 2005 by New City Investment Managers (NCIM), owned by CQS, a global multi-strategy asset

manager with US\$14bn 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 managers' view: Favouring low-cost shale gas producers

Will Smith acknowledges that the recent sharp fall in the oil price will have a significant effect on the North American shale oil & gas industry and has reduced CYN's overall oil & gas sector exposure from 36% at end-October 2014 to 31% at end-December 2014. He expects the greatest effect of a lower oil price to be on producers with high decline rates that will be challenged to fund the high levels of investment required to maintain steady production and is avoiding exposure to these companies. Reduced profitability across the industry is expected to lead to major reductions in capital expenditure, which will particularly affect exploration and service companies and CYN's exposure to both of these sub-sectors has been considerably reduced with only one oil services company still in the portfolio. The gas market is considered to be relatively unaffected by the fall in the oil price, with seasonal demand factors expected to be the main influence on gas prices. Within the oil & gas sector, the managers favour low-cost shale gas producers, particularly those currently paying dividends, and Vermilion Energy and ARC Resources remain top 10 holdings in the portfolio.

Will Smith sees major challenges to supply growth across base metals markets combined with continuing real commodity demand growth providing strong fundamental price drivers, which leads him to favour copper and nickel exposure (together 7.9% of the portfolio), reflected by CYN's top 10 holdings in Sirius Resources and Sandfire Resources. Sirius Resources recently secured funding to develop its high-grade, low cash cost Nova Nickel project in Western Australia and benefits from several other exploration projects. Sandfire Resources is an Australian copper producer with a growing exploration portfolio. Smith sees the relative stability of the gold price during 2014 as a potentially positive sign for the sector and has added to gold exposure in addition to copper and nickel exposure as oil & gas exposure has reduced. In particular, he has favoured increasing exposure to companies expected to benefit from lower costs due to the fall in the price of oil-based consumables as well as those with a high proportion of Australian dollar denominated costs expected to benefit from the recent weakness of the Australian dollar against the US dollar.

The takeover of two of CYN's top 20 holdings, Asian Plantations by Felda Global Ventures in the second half of 2014 and the anticipated completion of the takeover of New Britain Palm Oil by Sime Darby in early 2015, has seen the manager increase exposure to Plant Impact, which has become a top 10 holding, and add United Cacao to the portfolio to increase soft commodity exposure. Plant Impact develops crop enhancement products to improve yield and quality and is considered by the managers to have significant growth potential. United Cacao is a recently listed but well-established Peruvian cocoa plantation owner expected to benefit from rapidly rising global demand.

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

While the portfolio remains diversified with exposure to 176 equity and fixed income issues at 31 December 2014, the number of holdings has reduced from 213 at 31 December 2013. Over this period, the weighting of the top 10 holdings has increased from 27% to 34% and the weighting of the top 20 holdings has increased from 42% to 48%. This reflects the managers' aim to reduce the relatively large number of smaller investments and the proportion of holdings outside the top 80 declined from 15% to 10% in the year to 30 June 2014. Fixed interest securities and preference shares represented 32% of the portfolio at end-June and the manager reports a similar weighting at end-December 2014 (with non-resource holdings representing 20%, see Exhibit 3).

Exhibit 3: Portfolio sector weightings including fixed income allocations			
	End December 2014 (%)	End December 2013 (%)	Change
Oil & gas	30.8	39.3	-8.5
Gold	11.4	12.2	-0.8
Palm oil	10.6	11.1	-0.5
Finance*	8.7	5.8	2.9
Treasury stock*	5.6	0.0	5.6
Other investments*	5.4	5.0	0.4
Agriculture	4.7	1.7	3.0
Copper	4.7	4.1	0.6
Nickel	3.2	2.9	0.3
Uranium	3.2	4.1	-0.9
Silver	2.8	1.2	1.6
Rare earth	2.5	2.3	0.2
Diamonds	2.1	2.1	0.0
Alternative energy	2.1	1.4	0.7
Other mining investments	1.4	2.8	-1.4
Iron ore	0.6	2.0	-1.4
Platinum	0.2	0.1	0.1
Steel	0.0	0.9	-0.9
Rubber	0.0	0.5	-0.5
Coal	0.0	0.4	-0.4
	100.0	100.0	

Source: City Natural Resources High Yield Trust, Edison Investment Research. Note: *Non-resource related fixed income securities and preference shares.

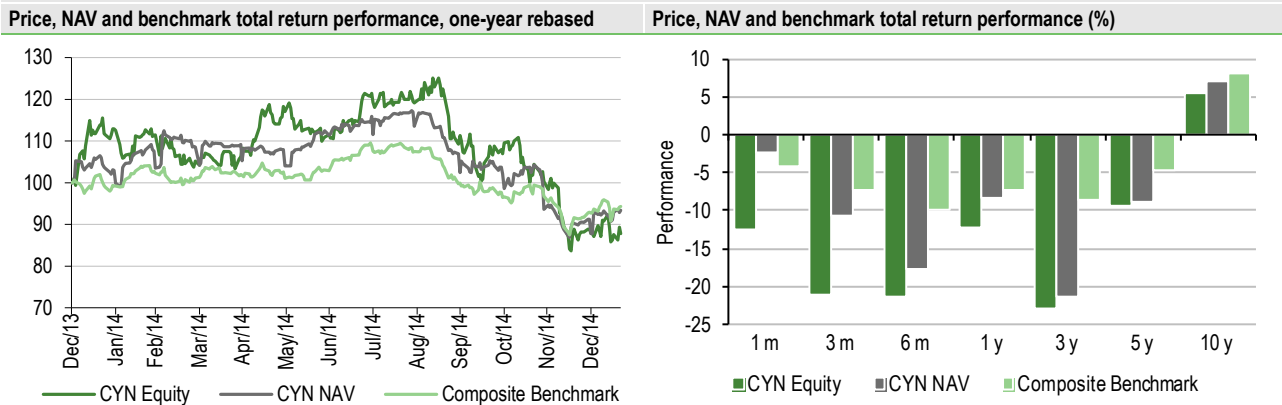
Similar to a year earlier, at 31 December 2014, CYN's largest weighting was to the oil & gas sector despite a nine percentage point reduction in exposure, the largest change in the period. Gold and palm oil represent CYN's second and third largest weightings, with exposures relatively unchanged over the year. Palm oil exposure comes from two of CYN's largest investments, REA Holdings and New Britain Palm Oil, the latter subject to an all-cash takeover offer scheduled to complete by March 2015. Over the year to 31 December 2014, there were significant increases in exposure to treasury stock, agriculture and finance, which more than offset the reduction in oil & gas exposure.

Performance: Similar to benchmark over one year

As shown in Exhibit 5, while CYN has underperformed its composite benchmark (weighted two-thirds to the Euromoney Global Mining Index and one-third to the Credit Suisse High Yield Index) over one, three, five and 10 years in terms of share price and NAV total return, relative performance has stabilised over the last year. It is worth noting that the benchmark does not include any oil & gas exposure and CYN's c 30% exposure to the sector means that its performance can deviate substantially from the benchmark. As illustrated in Exhibit 6, CYN has seen broadly offsetting periods of marked outperformance and underperformance over the last 10 years. Small- and mid-

cap mining shares underperformed their large-cap peers during 2012 and 2013 and the manager highlights this as contributing to the trust's weak relative performance during this period as well as Canadian and Australian dollar weakness relative to sterling. CYN's outperformance from January 2006 to July 2007 and from April 2010 to March 2011 coincides with small-cap outperformance.

Exhibit 4: Investment trust performance to 31 December 2014



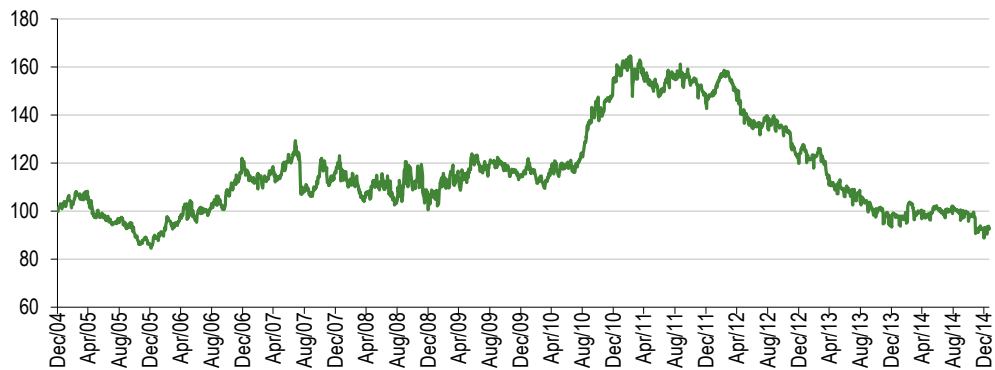
Source: Thomson Datastream, Bloomberg, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

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	(8.6)	(14.9)	(12.6)	(5.2)	(39.6)	(22.0)	(21.4)
NAV versus Composite Benchmark	2.0	(3.7)	(8.8)	(1.3)	(36.1)	(19.6)	(7.5)
Price versus Euromoney Global Mining	(7.5)	(11.4)	(6.7)	1.0	(28.6)	(3.9)	(16.3)
NAV versus Euromoney Global Mining	3.2	0.2	(2.6)	5.3	(24.6)	(1.0)	(1.5)
Price versus CRB Commodity	(3.5)	(8.0)	(3.7)	0.8	(38.8)	(27.3)	43.7
NAV versus CRB Commodity	7.7	4.1	0.5	5.0	(35.3)	(25.1)	69.1

Source: Thomson Datastream, Bloomberg, Edison Investment Research. Note: Data to end-December 2014 and indices £ adjusted. Geometric calculation.

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

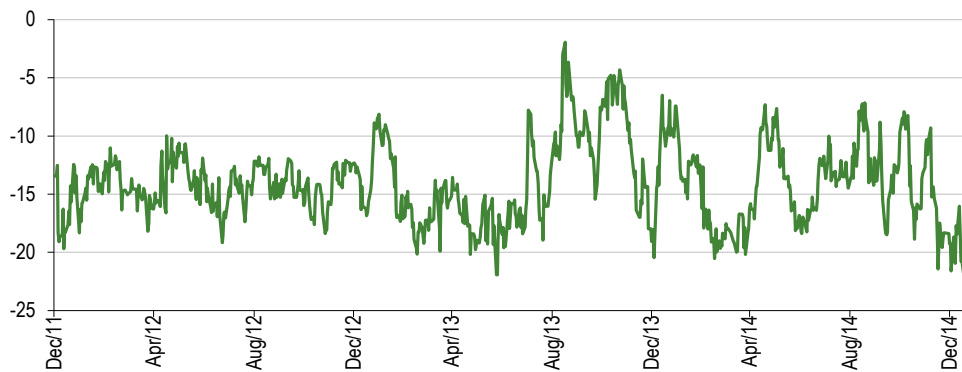


Source: Thomson Datastream, Bloomberg, Edison Investment Research

Discount: Wider than average

CYN has annually renewed authority to allot and repurchase up to 14.99% of its shares in issue. There is no active discount management policy and no shares have been bought back since CYN's launch in 2003. Exhibit 7 illustrates that while discount volatility increased in mid-2013, the average discount has subsequently narrowed to 13% from 15% over the prior 18 months. Over the last year, the discount has ranged from 6% to 23% and currently stands at the higher end of this range.

Exhibit 7: Share price discount to NAV (including income) over three years (%)



Source: Thomson Datastream, Edison Investment Research

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 these dates each year at a price of 377.2 pence nominal per share. The CULS provide structural gearing with no bank debt held since their issue in September 2011. Net gearing is managed through the level of cash held and has generally been kept within a 20% to 25% range since the CULS were issued. As at 31 December 2014, CYN had gross gearing of 44% and net gearing of 22% with £18.4m held in cash. The expected cash proceeds from New Britain Palm Oil's takeover would bring net gearing below 20%.

CYN pays a monthly management fee of 0.1% of net assets (excluding investments in other funds managed by NCIM), equating to 1.2% per year, and no performance fee is payable. Management fees are allocated 75:25 to capital and revenue. The ongoing charge for FY14 was 1.7%.

Dividend policy

The board believes that dividends contribute an important element of stability in the volatile asset class in which CYN invests and has maintained a focus on income and dividends since CYN's launch in 2003. Dividends have been paid quarterly since 2004 and the total dividend has been increased in each financial year since 2006. For the year to 30 June 2014, the dividend increased 1.8% to 5.60p and the first two quarterly dividends for FY15 have been maintained at 0.86p.

CYN aims to maintain or increase the total dividend in each financial year and reserves have been accumulated to enable fluctuations in underlying income generation to be smoothed. The majority of income is derived from overseas securities and affected by currency movements so the strength of sterling had a significant unfavourable effect in FY14. Although the board expects the current dividend level to be covered by earnings in FY15, it is prepared to utilise revenue reserves to maintain the dividend, as long as it deems that there is no material risk to longer-term income generation. At 30 June 2014, revenue reserves represented 1.7 years of dividend payments.

Peer group comparison

Exhibit 8 illustrates a closed-ended peer group comparison across the commodities and natural resources sector. We have taken the AIC specialist commodities and natural resources sector

constituents and excluded funds with a market capitalisation below £10m to give a peer group of nine trusts. CYN's NAV total return is ahead of the peer group average over one and 10 years, while modestly below the peer group average over three and five years. CYN's share price discount to NAV is wider than the peer group average, while its ongoing charge is below average. Although CYN's net gearing is higher than the peer group average, its debt is broadly matched by its investments in fixed income securities, which leaves its equity portfolio largely ungeared. CYN is one of only four dividend-paying trusts in the peer group.

Exhibit 8: Commodities and natural resources sector peer group, as at 21 January 2015

% 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 High Yield	68.0	(10.0)	(55.3)	(36.5)	95.3	(20.8)	1.70	No	124	5.5
Altus Resource Capital	23.0	(17.9)	(67.0)	(51.5)		(8.5)	2.47	Yes	94	
Baker Steel Resources	21.5	(27.4)	(65.3)			(33.3)	2.17	Yes	100	
BlackRock Commodities Income	93.7	(14.0)	(23.6)	(10.3)		3.3	1.39	No	104	6.7
BlackRock World Mining Trust	552.4	(27.3)	(53.6)	(41.7)	65.9	(7.9)	1.37	No	112	6.7
El Oro	38.6	6.3	(24.8)	4.8		(37.8)	2.23	Yes	147	6.2
Geiger Counter	13.8	(21.6)	(66.4)	(65.0)		(27.4)	2.66	Yes	115	
Golden Prospect Precious Metals	18.8	(11.3)	(64.3)	(34.3)		(11.2)	2.37	Yes	101	
Riverstone Energy	665.3	9.6				(17.6)	0.87	Yes	99	
Average	166.1	(12.6)	(52.5)	(33.5)	80.6	(17.9)	1.91		111	6.3

Source: Morningstar, Edison Investment Research. Note: TR=total returns. Net gearing is total assets less cash/cash equivalents as a percentage of shareholders' funds.

The board

The board has consisted of five independent non-executive directors since the appointment in September 2014 of Alun Evans, who has more than 35 years' experience in the investment management industry. 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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