

Bloomberg

Harvard, MIT Bonds Help RS Tax-Exempt Fund Top Rivals

By Sree Vidya Bhaktavatsalam with reporting by Gillian Wee

March 31 (Bloomberg) — RS Tax-Exempt Fund outperformed almost all rivals in the past year by buying bonds that Harvard University and the Massachusetts Institute of Technology sold to help them through a cash squeeze.

The \$125 million municipal bond fund, managed by Alexander Grant, climbed 4.06 percent in the past year through yesterday, while rivals lost an average of 3.3 percent, according to data compiled by Morningstar Inc. in Chicago. That ranks third amid the worst market for tax-free municipal mutual funds since 1980.

"Towards the end of 2008, we saw what we call 'museum pieces,'" Grant, 60, said in a telephone interview from his office in New York. "There was an inordinate supply of Ivy League issuances, something which we never really saw before," referring to a group of eight northeastern U.S. schools.

Harvard, Princeton University and MIT, which isn't part of the Ivy League, issued bonds last year after investment losses left them short of cash. U.S. higher-education endowments lost an average of 24 percent in the last six months of 2008, forcing schools that rely on investment income to issue bonds or cut costs by measures such as eliminating jobs or halting construction projects.

Shareholders typically choose funds of municipal bonds, which are issued by cities, counties and states, because they are shielded from federal taxes. Nonprofit universities and hospitals can also issue tax-exempt bonds.

Municipal bonds tumbled last year after the collapse of the \$330 billion auction-rate securities market and downgrades of bond insurers drove up borrowing costs.

Forced Sales

Investors pulled a record \$11 billion out of municipal-bond mutual funds in the last three months of the year, according to AMG Data Services in Arcata, California, forcing many managers to sell securities into a weak market and locking in losses.

Grant, a graduate of the State University of New York at Buffalo, manages about \$1.5 billion in assets for San Francisco-based RS Investments. He has run RS Tax-Exempt since 1993, and the fund carries a four-star rating from Morningstar, the research firm's second-highest.

RS Investments, a unit of insurer New York's Guardian Life Insurance Co. of America, oversees \$16 billion in mutual funds and accounts for institutions.

Grant put 15 percent of RS Tax-Exempt's assets into bonds issued by Harvard, MIT, Columbia University, Princeton University and Vanderbilt University, a record for the fund.

The universities' bond sales were intended to fund construction projects, refinance debt and allow the institutions to hold onto illiquid investments such as private-equity funds and real estate.

Harvard

Harvard issued \$2.5 billion in bonds in December, after losing

22 percent, or \$8 billion, on its endowment from July to November. It said assets might drop as much as 30 percent in the fiscal year ending in June.

The Cambridge, Massachusetts, university said March 19 that it will reduce the income it draws from its endowment by about 15 percent during the next two years. The fund contributed \$1.2 billion of Harvard's \$3.5 billion in revenue in the fiscal year ended June 30.

Harvard used its bond sales to refinance variable-rate debt, pay off commercial paper and end swap agreements.

As of Dec. 31, Grant held Harvard bonds with a 5.5 percent annual coupon, due in 2036, at a yield of 5.8 percent. He bought MIT bonds with a 6 percent annual coupon, also maturing in 2036.

Columbia, Princeton

Grant owns Columbia bonds with an annual coupon of 5 percent, due in 2029, and Princeton debt maturing in 2033 that pays an annual rate of 5 percent.

In March, Grant bought bonds from Vanderbilt. The Nashville, Tennessee, university sold bonds with a final maturity of 2024 and an annual coupon of 5.5 percent that were priced to yield 5.15 percent, according to Bloomberg data.

Grant lowered his holdings last year in bonds guaranteed by monoline insurers such as MBIA Inc. and Ambac Financial Group Inc., which lost their top AAA ratings after losses related to the credit crisis. When those ratings collapsed, cities and states saw the value of their bonds drop. The value of municipal issues with junk ratings fell by half.

The average rating of bonds in Grant's portfolio is AA, the third-highest rating given by Standard & Poor's.

His bets helped RS Tax-Exempt limit its loss to 0.2 percent in 2008, making it the best municipal-bond fund of the year, according to Morningstar. The average rival lost 7.5 percent, the worst return in 28 years, Morningstar said.

Focus on Ratings

Since January, the emphasis on highly rated bonds has caused RS Tax-Exempt Fund to lag behind peers as higher-yielding debt with lower ratings rebounded in value. The fund has advanced 3.26 percent this year, compared with the 5.05 percent average increase for rivals.

In the past year, the RS Tax-Exempt Fund trailed only the \$142 million First Investors Insured Tax Exempt Fund II, which has climbed 4.77 percent, and the \$28 million Madison Mosaic Tax Free National Fund, which has advanced 4.64 percent.

Grant says he'll continue to focus on buying higher-rated bonds for the most part. He will look at lower-rated bonds only if he deems them very cheap compared with the level of risk.

"In this type of environment, it's important to stick to quality," Grant said.

April 2009

RS Investments has no editorial control over the content, subject matter and timing of the article and is independent of *Bloomberg* and its publisher. RS Investments makes no representation as to the truth or accuracy of the article and takes no responsibility for any views expressed. The views reported in the article do not constitute investment advice. Investors should consult investment professionals regarding their individual investment programs. Since the date of publication, economic and market conditions and the portfolio manager's views of the prospects of any particular investments may have changed.

The RS Tax-Exempt Fund invests so that under normal circumstances at least 80% of its net assets is invested in bonds exempt from federal income tax including alternative minimum tax (AMT). A portion of the Fund's assets may be invested in bonds that are taxable or subject to AMT. You may also be subject to capital gains tax, or state and/or local taxes.

© 2009 Morningstar, Inc. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete, or timely. Neither Morningstar nor its content providers is responsible for any damages or losses arising from any use of this information. Past performance does not guarantee future results.

Please note, some of the Morningstar proprietary calculations, including the Morningstar Rating™, are not customarily calculated based on adjusted historical returns. The evaluation of this investment does not affect the retail mutual fund data published by Morningstar. For each retail mutual fund with at least three-year history, Morningstar calculates a Morningstar Rating™ based on Morningstar Risk-Adjusted Return measure that accounts for variation in a fund's monthly performance (including the effects of sales charges, loads, and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and bottom 10% receive 1 star. (Each share class is counted as a fraction of one fund within this scale and rated separately, which may cause slight variations in the distribution percentages.) The Overall Morningstar Rating for a retail mutual fund is derived from a weighted average of the performance Morningstar Rating metric is then compared against the retail mutual fund universe breakpoints to determine its hypothetical rating.

RS Tax-Exempt Fund was rated against the following numbers of Muni National Long funds over the following time periods: 253 funds in the last three years, 240 funds in the last five years, and 209 funds in the last ten years. With respect to these Muni National Long funds, RS Tax-Exempt Fund received a Morningstar Rating of four stars for the three-, five- and 10-year periods, respectively. Past performance is no guarantee of future results.

RS Funds are sold by prospectus only. The article enclosed is not a prospectus. You should carefully consider the investment objectives, risks, charges and expenses of the RS Funds before making an investment decision. The prospectus contains this and other important information. Please read it carefully before investing or sending money. To obtain a copy, please call 800-766-3863 or visit www.RSInvestments.com.

RS Tax-Exempt Fund (GUTEX) Performance [†] (Average Annual Total Returns as of 3/31/09)						
	First Quarter 2009	1-Year	3-Year	5-Year	10-Year	Since Inception (2/16/93)
RS Tax-Exempt Fund, Class A						
without sales charge	3.37%	4.04%	3.11%	3.30%	4.59%	4.75%
with maximum sales charge	-0.51%	0.11%	1.79%	2.52%	4.20%	4.50%
Barclays Capital Municipal Bond Index ¹	4.22%	2.27%	3.19%	3.21%	4.59%	5.43%

Performance returns for periods of less than one year are not annualized.

Sector Allocation ² (As of 3/31/09)	
State General Obligation Bonds	7.5%
Local General Obligation Bonds	18.7%
Revenue Bonds	63.6%
Short-Term / Other Assets and Liabilities	10.2%

Top Ten Holdings ³ (As of 3/31/09)			
	Coupon	Maturity	% Fund
Massachusetts State	5.500	10/1/2020	1.68%
West Metro Fire Protection District	5.250	12/1/2026	1.45%
Kentucky Asset/Liability	5.250	9/1/2018	1.44%
King County Wash Swr	5.500	1/1/2030	1.38%
Maryland State Department Transportation	5.250	12/15/2017	1.28%
Garden State New Jersey Preservation	5.500	11/1/2015	1.28%
Missouri State Highways & Transport	5.250	5/1/2018	1.26%
Boise State University Idaho Revs	5.000	4/1/2034	1.24%
South Carolina State Public Services Authority	5.500	1/1/2015	1.24%
Wake County North Carolina	5.000	3/1/2018	1.23%

† Performance quoted represents past performance and does not guarantee future results. The Fund is the successor to The Guardian Tax-Exempt Fund; performance shown includes performance of the predecessor fund for periods prior to October 9, 2006. Investment return and principal value will fluctuate, so shares, when redeemed, may be worth more or less than their original cost. As of the most current prospectus, the Fund's total gross annual operating expense ratio for the Class A shares is 0.97%. Class A performance quoted "with maximum sales charge" reflects the current maximum sales charge of 3.75%. Please read the prospectus carefully for more information on sales charges as they do not apply in all cases and if applied are reduced for larger purchases. Any sales charges are in addition to the Fund's fees and expenses as detailed in the Fund's most current prospectus. Fees and expenses are factored into the net asset value of your shares and any performance numbers we release. Total return figures reflect an expense limitation in effect during the periods shown; without such limitation, the performance shown would have been lower. Performance results assume the reinvestment of dividends and capital gains. The return figures shown do not reflect the deduction of taxes that a shareholder may pay on Fund distributions or the redemption of Fund shares. Current and month-end performance information, which may be lower or higher than that cited, is available by contacting RS Investments at 800-766-3863 and is frequently updated on our web site: www.RSInvestments.com.

¹ The Barclays Capital Municipal Bond Index is generally considered to be representative of U.S. municipal bond market activity. Unlike the Fund, the index does not incur fees or expenses.

² The Fund's holdings are allocated to each sector based on their Barclays classification. If a holding is not classified by Barclays, it is assigned a Barclays designation by RS Investments. Cash includes short-term investments and net other assets and liabilities.

³ Portfolio holdings are subject to change and should not be considered a recommendation to buy or sell individual securities.

Distributed by: Guardian Investor Services LLC (GIS), 7 Hanover Square, New York, NY 10004.

GIS is a member: FINRA, SIPC.

© 2009 RS Investment Management Co. LLC.

RP921TE

EB 015498

Not A
Deposit

Not FDIC
or NCUA
Insured

May Lose
Value

No Bank or
Credit Union
Guarantee