RS | investments

First Quarter 2011 Mutual Fund Commentary
RS Emerging Markets Fund

Market Review

It has been a lackluster start to the year, with the emerging markets indices appreciating only slightly over the first three months. We believe that this performance in itself is notable in the face of two big global events that have dominated the headlines over the period - the unrest in North Africa and the Middle East and the tragic events in Japan.

The uprisings in North Africa and the Middle East have little bearing on the Fund given no direct exposure to this region, although the resulting increase in the price of oil comes with its own consequences especially for those oil importing countries such as Turkey, Indonesia and India.

From an oil supply perspective, the two biggest worries are Saudi Arabia (holds almost all of the world's spare capacity and is the world's largest producer) and Iran (a regime that is unlikely to go quietly and could threaten the Gulf crude trade and stability in Iraq). Signs of significant instability in either of these countries would likely send the oil price sharply higher in our view. Unrest in Saudi Arabia remains the bigger worry. However, the Kingdom has the means to buy acquiescence from its people and the signs are that the recently announced give-aways are working. We remain intrigued by the pace of change in this region. We are unconvinced by arguments that short-term oil production losses resulting from any period of disruption will quickly return to normal, as there are many historic examples of countries where this has not been the case. Consequently, we remain open to the possibility that energy prices will remain elevated over the medium-term.

We do not claim any particular insights into the short-term risks and opportunities arising from the Honshu earthquake, or pay too much heed to what we view as the fairly predictable trades suggested by most sell-side strategists. Of more interest to us is the continued resilience of stock markets in the face of more bad news.

This reminds us of what we view as an important belief; that the value of a company does not depend very much on its immediate prospects, and it is actually very difficult for an individual event, however dramatic, to interrupt or even significantly alter an enterprise's long term progress, and hence to change its valuation. Investors tend to underestimate the durability of businesses, and so they usually overreact to events.

At the end of last year, optimism of a sustained recovery in US demand manifested itself in the significant outperformance of EM exporters. While the Korean market has continued its strong run, Taiwan delivered negative returns over the quarter with concerns over pricing and margins at some semiconductor companies. The start of the year also saw marked underperformance in some of 2010's best returning markets – Indonesia is a prime example – amid growing concerns of macro imbalances and the direction of "hot money." Hot Money comprises flows between financial markets as investors attempt to ensure they get the highest short-term interest rates possible.

Fears that the steady rise in headline CPI numbers across the region are symptomatic of central banks having fallen dangerously behind the curve refocused attention on the age old EM Achilles heel of funding gaps, particularly where commodities account for a significant portion of the deficit. A number of central banks face a policy "trilemma," namely managing exchange rates, monetary policy, and capital flows. There is clearly a risk that mistakes are made. The Turkish market suffered

from its unorthodox policy moves of cutting interest rates while increasing reserve requirements. We still like the long-term structural story here but we do have concerns that existing policy measures will prove insufficient.

Performance and Portfolio Review

The RS Emerging Markets Fund (Class A Shares) returned -0.52% during the quarter, underperforming the 2.10% return of the MSCI Emerging Market Index[1]. With the spike in the oil price, the Russian market was one of the top performers in the emerging universe and the Russian underweight combined with stock selection in the country was the biggest detractor from relative performance. The Fund did not have a position in Gazprom (gas producer), which performed very well. However, we have recently taken a new position for the Fund. We cannot rule out the possibility that unconventional gas will play a larger part in the European supply matrix over time, but our analysis suggests it is unlikely to develop as quickly as it has done elsewhere in the world. We also bought a position in Lukoil (oil producer) (1.53% position as of 3/31/11) during the quarter. It is becoming clear in our view that the government is keen to remove some of the oil tax burden in order to improve the growth outlook for the sector as tax holidays on new "greenfield" investment have already been introduced.

Despite rebounding in March, the Indian market was a poor performer over the three months. It was hit by the combination of inflation and deficit fears and a large number of high profile corporate governance scandals. A range of holdings from IVRCL Infrastructure (engineer) (0.00%) and GAIL India (gas distributor) (1.10%) to Mahindra & Mahindra (auto and tractor manufacturer) (0.00%) and Hero Honda (two-wheeler manufacturer) (0.71%) therefore detracted from relative performance. We have recently sold the positions in IVRCL and Mahindra. In the former case, changes in management guidance pose significant questions over the future of the business and we are worried about the debt profile and poor cash flow dynamics. Mahindra & Mahindra has embarked on an increasingly unfocused M&A spree in our view and there is shorter-term potential for a significant margin squeeze from rising raw material prices and market competition. As a result, the holding has been sold.

On a more positive note, the Fund's exposure to frontier oil exploration helped relative performance with holdings in Dragon Oil (Turkmenistan) (3.33%), Cairn Energy (Rajasthan and Greenland) (0.00%), Chariot Oil and Gas (Namibia) (0.89%) and Tullow Oil (Ghana and Uganda) (1.13%) performing well. Offshore Brazil, West Africa and a number of smaller basins are all entering phases of strong development growth and we expect production to surprise on the upside. Tightening energy markets also boosted the share price performance of coal producers Bumi Resources (Indonesia) (1.50%) and China Shenhua (1.95%), and coal to liquids manufacturer Sasol (South Africa) (1.86%). We expect that the scale of the energy requirement from the emerging world, and its

Performance quoted represents past performance and does not guarantee future results. The Fund is the successor to The Guardian Baillie Gifford Emerging Markets 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. The Fund's total gross annual operating expense ratio as of the most current prospectus for the Class A Shares is 1.62%. Please refer to the most current Fund prospectus for complete details on expenses including fees. The performance quoted, unless otherwise indicated, does not reflect the current maximum sales charge of 4.75% that became effective on October 9, 2006. If the maximum sales charge were included, the performance stated above would be lower. 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. Performance results assume the reinvestment of dividends and capital gains. 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 or visiting www.RSinvestments.com.

focus on countries like China and India who have significant domestic reserves of cheap coal, will ensure that coal remains much in demand over the next decade.

A number of technology stocks performed well and among them was the Chinese internet search engine Baidu (2.92%). The company announced better than expected financial results for 2010. Its mobile search technology, as well as its dominant market position, should continue to propel its growth in our view. The power of distributed information is being unlocked and with the advent of new, user friendly technologies to assist the reach of online search and advertising, we remain very excited about the prospects for this company.

Outlook

We have reduced financials exposure in markets that look vulnerable to us on account of policy error or a higher oil price in the near term, notably Turkey and Indonesia. A commonly held view is that Indonesia is a commodity producer and thus a beneficiary of higher prices. While partly correct, it is still a large importer of oil and a persistently high oil price is likely to be felt in that region. We also believe that the recent correction in India should not be viewed as a buying opportunity, at least in the near term. We remain concerned that structural reforms there are not being addressed, the lending cycle is still too aggressive, levels of questionable M&A activity are rising, and we believe concerns over corporate governance are far from groundless.

The inflation debate is finely balanced between those who see it as a transitory phenomenon, reflecting weather-related food supply disruptions, and those who believe it is only a matter of time before core inflation numbers start to reflect more entrenched upward pressures. Certainly food has been a major contributing factor and for the time being, the weight of evidence supports the majority of central bankers who believe that core inflation remains benign.

More important, perhaps, is that policy may be far tighter in a number of emerging economies than a cursory glance at real rates suggests. There has been far more vigorous use of credit controls, with loan quotas and hikes in reserve requirements underway across the region. The potential for currency appreciation as a ‘safety valve’ remains another option in our view. In the meantime, some “hotter money” heading for the exits is unlikely to be wholly undesirable for emerging policy makers who have been struggling to remain masters of their own destiny.

Portfolio positioning has not altered significantly of late with an ongoing collection of domestically-focused Asian stocks being balanced by overweight positions in energy companies and a number of tech exporters that we continue to view as being materially undervalued. Encouragingly, and perhaps unsurprisingly after such a volatile period for share prices, we seem to be in a particularly fertile period for new buying ideas. Despite the near-term headwinds that many emerging market countries face, we remain optimistic on the long-term growth story of emerging markets. If the oil price was to stay at these elevated levels for a prolonged period, it would clearly impact our domestic Asia portfolio exposure. However, on the flip side, the high beta energy companies, ranging from smaller E&P names to the relatively geared oil companies like Petrobras and Sasol, should do well in our view.

We thank you for your continued support.

Sincerely,

Richard Sneller
Co-Portfolio Manager

William Sutcliffe
Co-Portfolio Manager

As with all mutual funds, the value of an investment in the Fund could decline, so you could lose money. International investing involves special risks, which include changes in currency rates, foreign taxation and differences in auditing standards and securities regulations, political uncertainty and greater volatility. The value of a debt security is affected by changes in interest rates and is subject to any credit risk of the issuer or guarantor of the security. These risks are even greater when investing in emerging markets.

Any discussions of specific securities should not be considered a recommendation to buy or sell those securities. Fund holdings will vary.

Except as otherwise specifically stated, all information and portfolio manager commentary, including portfolio security positions, is as of March 31, 2011.

RS Funds are sold by prospectus only. 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.

Regional Allocation
(As of 3/31/11)

Asia-Pacific	53.1%
Latin America	21.7%
Europe	7.6%
Middle East & Africa	3.5%
Other	4.0%
Cash	2.1%

Top Ten Holdings[2]
(As of 3/31/11)

Company	Country	Percentage of Total Net Assets
Petrobras	Brazil	4.89%
Samsung Electronics	South Korea	3.48%
Dragon Oil	Other Emerging	3.33%
Baidu	China	2.92%
China Mobile	China	2.40%
Hon Hai Precision Industry Co., Ltd.	Taiwan	2.08%
Vale S. A.	Brazil	2.00%
Taiwan Semiconductor Manufacturing Company	Taiwan	1.99%
China Shenhua Energy Company Ltd.	China	1.95%
Hyundai Mobis	South Korea	1.89%

Performance

(Average Annual Total Returns as of 3/31/11)

	First Quarter 2011	1-Year	3-Year	5-Year	10-Year	Since Inception[3]
RS Emerging Markets Fund, Class A						
without sales charge	-0.52%	16.23%	3.75%	11.87%	18.24%	10.99%
with maximum sales charge	-5.24%	10.69%	2.09%	10.78%	17.67%	10.61%
MSCI EMF Index[1]	2.10%	18.78%	4.62%	11.01%	17.12%	8.77%

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

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1 The Morgan Stanley Capital International (MSCI) Emerging Markets Free (EMF) Index is a market capitalization-weighted benchmark index composed of companies representative of the market structure of emerging market countries in Europe, Latin America, and the Pacific Basin: it excludes closed markets and those shares in otherwise free markets which may not be purchased by foreigners. There are no expenses associated with this index while there are expenses associated with the Fund. The MSCI EMF Index is an unmanaged index and is not available for direct investment.
2 Portfolio holdings are subject to change and should not be considered a recommendation to buy or sell individual securities.
3 Class A shares inception date May 1, 1997.

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