



## First Quarter 2012 Mutual Fund Commentary RS Tax-Exempt Fund

### Performance

(Average Annual Total Returns as of 3/31/2012)

RS Tax-Exempt Fund (Class A – GUTEX )

	First Quarter 2012	1-Year	3-Year	5-Year	10-Year	Since Inception (2/16/93)
without sales charge	1.60%	12.19%	7.22%	5.11%	5.40%	5.13%
with maximum sales charge	-2.24%	7.95%	5.85%	4.31%	5.00%	4.92%
Barclays Municipal Bond Index <sup>1</sup>	1.75%	12.07%	7.70%	5.42%	5.46%	5.78%

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

### Fund Highlights

#### Portfolio Overweights

- Education
- Transportation
- Water and sewer

#### Portfolio Underweights

- Healthcare
- Leasing
- State general obligations

### Outlook

- Upcoming tax policy decisions could have a far-reaching impact on the municipal market.

Performance quoted represents past performance and does not guarantee future results. Investment return and principal value will fluctuate, so shares, when redeemed, may be worth more or less than their original cost. The performance quoted, “with maximum sales charge” reflects the current maximum sales charge of 3.75%. The Fund’s total gross/net annual operating expense ratio as of the most current prospectus for the Class A Shares is 0.96%/0.80%. Current performance may be lower or higher than performance data quoted. Performance current to the most recent month-end is available by contacting RS Investments at 800-766-3863 and is frequently updated on our Web site: [www.RSinvestments.com](http://www.RSinvestments.com).

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. The net expense ratio quoted above reflects a contractual expense limitation which will continue through 4/30/11. The views expressed in the portfolio manager commentaries are those of the Fund’s portfolio manager(s) and are subject to change without notice. Please refer to the most current Fund prospectus for complete details on expenses including fees. 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. Certain share classes are subject to lower maximum sales charges whether paid at the time of purchase or deferred. A “deferred sales charge” also known as “back end load” or “CDSC” is incurred when liquidating an A share purchase over \$1 million, for example, before a specified holding period. 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.

## Fund Commentary

### Performance

The RS Tax-Exempt Fund (Class A shares) (the Fund), had a total rate of return of 1.60% for the first quarter ended March 31, 2012, underperforming its benchmark, the Barclays Municipal Bond Index, which returned 1.75%. For the twelve months ended March 31, 2012, the Fund had a total return of 12.19%, compared with the benchmark return of 12.07%. We would note that, unlike the Fund, the benchmark return does not reflect expenses. In addition, at any one time, the benchmark has approximately 46,081 issues, whereas the Fund generally has only about 210 to 230 carefully selected issues, some of which may not be in the benchmark.

We believe that longer-term peer group performance data from Lipper provides a more meaningful comparison than short term performance relative to the benchmark. Funds in the Lipper General Municipal Debt Fund<sup>2</sup> category invest primarily in municipal debt issues in the top four credit ratings. Lipper rankings are based on total return with dividends reinvested and do not reflect sales charges. As shown in the chart below, the Fund had favorable performance compared with the Lipper peer group for the five- and 10-year periods ended March 31, 2012. Over this longer term, the Fund has been one of the best performing national tax-exempt funds, as determined by Lipper.<sup>2</sup>

The Fund's longer duration relative to its benchmark combined with an underweight in the 30-year part of the municipal curve and an overweight to the 10-year part of the municipal curve were the largest detractors from relative performance in the first quarter. Our underweights in the outperforming healthcare, special tax and leasing sectors detracted, as did our focus on higher-rated credits in a quarter when lower-rated credits outperformed. Sector and security selection were strongly positive, and we benefitted from our overweights in the outperforming transportation, industrial and local general obligation sectors.

<b>(As of 3/31/2012)</b>	<b>1-Year</b>	<b>3-Year</b>	<b>5-Year</b>	<b>10-Year</b>
RS Tax-Exempt Fund (Class A) Average Annual Total Return	12.19%	7.22%	5.11%	5.40%
Lipper General Municipal Debt Funds Average Annual Total Return	13.38%	8.83%	4.13%	4.53%
Lipper General Municipal Debt Funds Category Ranking*	184/246	175/221	32/192	23/166
Lipper General Municipal Debt Funds Category Percentile	75%	79%	17%	14%

*\*Lipper rankings are based on total return with dividends reinvested and do not take into account or reflect sales charges.*

### Market Overview

The markets swung into risk-on mode in the first quarter of 2012, with investors embracing risk as decisively as they had shunned it at other times during the past year. While sovereign debt problems and recession in Europe continued to dominate the headlines, massive lending to European banks by the European Central Bank (ECB) restored some sense of stability, and investors drew confidence from signs of momentum in the U.S. economic recovery.

Perhaps most importantly, the U.S. unemployment rate improved substantially in recent months, falling to 8.2% in March. The number of people filing initial unemployment claims also hit a four-year low as the pace of layoffs slowed. These developments created confidence that recent unexpectedly strong labor market indicators were not a fluke. By saying it plans to keep interest rates near zero into 2014 and leaving open the possibility of additional stimulus, the Fed signaled its continued willingness to intervene if the U.S. economy backslides. Investors finally seemed reassured enough to seek out yield, which has been unattractively low in Treasuries.

Despite these generally positive trends, the problems that have periodically sent investors fleeing into risk-off mode over the past year haven't suddenly vanished. The U.S. economic recovery is still modest and is constrained by stubbornly high unemployment and an overhang from the housing market. Employment growth remains stagnant in some regions. We believe there could be further setbacks if the government fails to adequately address tax cuts that are due to expire at year end and automatic federal spending cuts that are slated to begin at the start of next year. Congress may also need to revisit the highly divisive debt limit issue soon after the November elections.

Municipal debt, which tends to be less affected by events outside the U.S. continues to play a valuable role for investors. And the quarter was a busy one, with \$78.3 billion in municipals issued, a 63.5% increase over the \$47.9 billion issued in the first quarter of 2011. Refundings, primarily to take advantage of low interest rates, played a large role in this, representing 57% of issuance, compared with 33% for the same period in 2011.

In municipals and throughout the credit markets, lower-rated credits generally outperformed higher-rated ones. The breakdown of returns for the Barclays Municipal Bond Index for first quarter was:

- AAA 0.74%
- AA 1.42%
- A 2.19%
- BBB 4.17%<sup>1</sup>

#### **Portfolio Review**

During the first quarter, the RS Tax-Exempt Fund maintained an overall high-grade credit profile and held no bonds that were not rated by a rating agency or that were rated below investment grade. The Fund did not use derivatives to boost returns.

In keeping with our investment strategy, we maintained an overall focus on issues with higher credit ratings and did not reach for yield at the expense of credit quality. As of March 31, the Fund's ratings allocation was:

- AAA or AA-rated 59.9%
- A-rated 19.5%
- BBB rated 13.2%
- Other assets and liabilities 7.4%

Our higher-rated focus is not the result of simple reliance on rating or insurance. Rather, we base our assessments on the fundamentals of each issuer. We seek to thoroughly understand the bonds we purchase, and we believe that understanding the revenue stream is essential to understanding the bond. We look for strong revenue that flows directly to the issuer, such as those we have found in California. Once a bond is purchased, we continue to monitor its cash flows.

Given the broad set of opportunities open to a national fund, we focus on what we believe to be quality issuers that offer value, and avoid large concentrations in any one issuer, insurer, industry, sector or state. When our research indicates upside potential for the bond and we feel we are properly compensated for risk, we may purchase select lower-rated credits, as we have done in the case of Puerto Rico sales tax bonds.

The Fund has stayed away from many local issues that typically depend on appropriations and have certificate of participation (COP) structures. COPs are not voter approved and usually depend on appropriations.

Although we generally avoid appropriation debt at the local and county levels, we view the state level differently given the long histories of support in many states, including California and New Jersey. Among the characteristics we examine in detail when evaluating state appropriation bonds are the size and history of the project and the need for it.

### **Outlook**

- We expect moderate U.S. GDP growth at or slightly above 2% this year, up from 1.6% in 2011. We expect core inflation to hold at about 2% year over year.
- Our better-than-consensus view on unemployment is that it will fall to 7.8% or slightly below by year end. Blue Chip consensus and Fed projections are for 8.1% to 8.5% unemployment by year end. Despite our more optimistic view on employment, we are forecasting restrained growth of 2% in real disposable income and consumer spending.
- The Fed continues to say it plans to keep the Fed Funds target rate at zero to 0.25% into 2014, and it continues to use unconventional policy tools to provide additional monetary stimulus. We see the Fed as prepared to intervene further if the economy falters or contagion risks from Europe escalate.
- Although they are improving, still-high unemployment and a weak housing market should continue to restrain economic growth. We expect housing prices to decline up to another 3% this year, but we believe this could be the bottom. A firmer conviction that home prices have hit bottom would support housing activity and the economy.
- Heavy lending to banks by the ECB has helped to stabilize the situation in Europe, postponing concerns about banking system liquidity into at least 2013. But the problems emanating from Europe continue to be a key wildcard for the markets.
- Given the tentativeness of the U.S. recovery and the seriousness of the problems in Europe, we believe investors are likely to remain skittish and markets should remain volatile.

Although the recession is over, many state and local governments have had to make difficult transitions. Many have done so by cutting their spending and work forces rather than raising taxes. Despite a steady pace of economic recovery for most states through the first two quarters of fiscal 2012, modest economic prospects and federal budget cuts mean significant uncertainty and possibly continued austerity for state and local governments.

We are particularly monitoring California's potential \$9.2 billion budget deficit for the fiscal year beginning July 1. California requires a two-thirds legislative majority or voter approval for tax increases, and the governor has been pitching an item for the November ballot that would help to balance the budget and restore funding to various state programs by raising sales and income taxes. If voters reject the tax increases, there would have to be budget cuts mid-year. The Fund currently holds California state bonds and we will continue to watch the situation closely.

In February, the Obama administration presented its proposed budget for fiscal 2013, which begins October 1. It recycled some previous municipal bond proposals, such as limiting the benefit of tax preference items (including tax-exempt interest) to 28% for taxpayers with incomes over \$250,000. It also proposed a "Buffett rule," which would replace the current alternative minimum tax with a new 30% minimum tax for incomes over \$1 million. While there is little expectation that anything can be achieved in a presidential election year, calls for tax reform may grow louder as the campaign escalates.

Given our investment approach of focusing on the quality and stability of issuers, we believe there are compelling opportunities for investors in the Fund. As we survey the many options that a national fund allows us, we will continue to put our experience and investment discipline to work to meet your investment needs.

Thank you for your investment and continued support.

Sincerely,



Alexander M. Grant, Jr.  
Portfolio Manager

*Guardian Investor Services LLC, the Fund's sub-adviser*

The foregoing is the opinion of the Fund's management team as of the date of this report and is subject to change without notice.

Bond funds are subject to interest rate risk, credit risk, and prepayment risk. When interest rates rise, bond prices generally fall, and when interest rates fall, bond prices generally rise. Currently, interest rates are at relatively low levels. Please keep in mind that in this kind of environment, the risk that bond prices may fall when interest rates rise is potentially greater. Investors in the Fund may be subject to alternative minimum tax (AMT) and certain other state and local taxes.

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, 2012.

***Mutual funds are offered 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](http://www.RSinvestments.com).***

**Sector Allocation  
(As of 3/31/2012)**

	<b>% Fund</b>
State General Obligation Bonds	11.17%
Local General Obligation Bonds	12.75%
Revenue Bonds	68.62%
Special Tax	6.19%
Housing	1.27%
Education	8.32%
Water and Sewer	10.41%
Transportation	18.82%
Power	4.83%
Leasing	6.32%
Resource Recovery	0.49%
Hospital / Nursing Home / Health Care	5.88%
Industrial Revenue	5.34%
Other	0.74%
Other Assets and Liabilities	7.46%

**Top Ten Holdings<sup>3</sup>  
(As of 3/31/2012)**

	<b>Coupon Rate</b>	<b>Maturity Date</b>	<b>% Fund</b>
New York St. Dorm. Auth. Revs. St. Supp. Debt.	5.000	5/15/2025	0.91%
Illinois St. G.O.	5.000	1/1/2019	0.84%

Tex. Private Activity Bd. Surface Transn. Corp.	6.880	12/31/2039	0.79%
Illinois St. G.O.	5.000	3/1/2017	0.75%
California St. Var. Purp. G.O.	5.130	4/1/2033	0.70%
St. John The Baptist Parish LA Rev.	5.130	6/1/2037	0.68%
Wayne Cnty. MI Arpt. Auth. Rev.	5.000	12/1/2020	0.65%
Metropolitan Transn. Auth. NY Rev.	5.000	11/15/2024	0.64%
Dallas-Fort Worth Tex. Intl. Arpt. Rev.	5.000	11/1/2023	0.63%
Hawaii St. G.O.	5.000	12/1/2031	0.63%

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<sup>1</sup> The Barclays Capital Municipal Bond Index total return data is provided by Barclays Capital. The Barclays Capital Municipal Bond Index is an unmanaged index that is generally considered to be representative of the municipal bond market and is not available for direct investment. There are no expenses associated with the index, but there are expenses associated with the Fund.

<sup>2</sup> Lipper, Inc. is an independent mutual fund monitoring and rating service. Its database of performance information is based on historical returns, which assume the reinvestment of dividends and distributions and the deduction of all fund expenses. Lipper return figures do not reflect the deduction of any sales charges that an investor may pay when purchasing or redeeming shares of the Fund.

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