

## Second Quarter 2010 Mutual Fund Commentary RS Large Cap Alpha Fund

### Performance and Market Commentary

For the second quarter of 2010, RS Large Cap Alpha Fund (Class A Shares) declined 10.51% versus the decline of 11.15% for the benchmark Russell 1000® Value Index<sup>1</sup>. The S&P 500® Index<sup>5</sup> declined 11.43% during the quarter. Year-to-date, the Fund declined 4.40% versus the 5.12% decline for the Russell 1000® Value Index and 6.62% decline for the S&P 500® Index. Despite the relative outperformance for the quarter and YTD periods, we are disappointed with the Fund's results given our absolute-return orientation and our focus on risk management.

The second quarter was a very difficult and volatile time for the U.S. equity markets, with the volatility index (VIX) nearly doubling during the quarter. With fears of a double dip recession becoming more prevalent, many investments that were strong performers during the first quarter sold off sharply during the second quarter. Nowhere was this more evident than in financials. In fact, the financial services sector went from being the Fund's best performing sector in the first quarter to one of its worst performers during the second quarter.

Concerns related to a slowing economy, deflation, Europe, and deteriorating credit all contributed to a reduction in investor appetite for a myriad of businesses. In addition, the uncertainty surrounding financial re-regulation cast a dark cloud over the financial services sector. With its focus on protecting consumers and de-risking our systemically important financial institutions, the primary goals surrounding financial reform legislation are well intended. We view improved regulatory oversight positively to the extent that it discourages excessive risk taking at the community and regional bank level. Importantly, given our keen focus on risk management, we have consciously avoided investments in companies that we felt would be overly exposed to re-regulation. Longer-term, it is our view that improved regulation will serve to eradicate the marginal lending models that have negatively affected the supply and demand dynamics of the credit markets. In turn, these reforms should improve risk-adjusted returns for those banks that possess solid underwriting standards and strong deposit franchises. As such, despite a challenging second quarter, we continue to believe in the merits of our financial investments and have used the recent sell-off as an opportunity to consolidate capital around our highest conviction ideas.

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 Fund's total gross annual operating expense ratio as of the most current prospectus for the Class A Shares is 1.04%. 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 and is available by contacting RS Investments at 800-766-3863 or visiting [www.RSinvestments.com](http://www.RSinvestments.com).

## **Portfolio Positioning**

### ***Financials***

We have increased the Fund's exposure to financial services over the past year as we became increasingly more constructive on the sector. During this period, we deployed incremental capital toward those financial services companies that we felt possessed solid capital positions, stable and reliable funding sources, strong management teams, increasing returns on capital, and solid risk management over our three year investment horizon. While we have been particularly focused on the banking industry, we continue to be very discriminating relative to the Fund's bank investments. We continue to look for businesses with solid deposit franchises and sound capital ratios that generate strong pre-provision cash flows. Specifically, we have concentrated our investments in Relationship Lenders, which are characterized as those that lend primarily to in-market customers with the goal of building a collection of "advantaged liabilities," as well as related fee-income business.

Unlike more transactional lenders that seek asset growth through the syndicate market, the strength of the Relationship Lender model exists in its ability to build "advantaged liabilities" in the form of core deposits. These deposits, many of which are housed in non-interest bearing accounts, provide our banks with a long-term, low cost capital source with limited liquidity triggers. In turn, when a core depositor seeks a loan, the bank enjoys a lower cost of funds (and lower leverage) relative to said credit given that the borrower is required to "self-fund" a portion of the loan with deposits. The relationship model also provides these banks with visibility into the inner workings of their respective lending bases, which should lead to solid and informed underwriting and better ongoing monitoring of outstanding credits. This superior knowledge of the borrower and related deposits should lower the risk grade and capital requirements of a loan portfolio, provided that the lender has been disciplined in its capital allocation process. It is therefore imperative that we understand how a given management team thinks and talks about capital allocation (e.g., return parameters, capital structure, operating culture, compensation measures). Finally, we focus on the capital adequacy of the business. In fact, many of our investments were initiated by participating in a capital raise that provided the business with what we deemed to be more than adequate levels of capital.

While we see early signs that credit losses may be peaking, our investment thesis does not rely on improving credit. To the contrary, in our analysis of these credit based financial institutions we spend the lion's share of our time and efforts stress testing our draconian downside case. We begin our work by vigorously analyzing the composition of the loan portfolio, understanding past and present underwriting standards, engaging in discussions with management regarding how they deal with problem credits and their most troubled assets. In addition to interviewing senior and middle management, we accomplish this by speaking with mortgage brokers, distressed asset buyers, strategic end users, and in-market (both bank and non-bank) competitors. These discussions help us identify the key risks to a particular banking model relative to credit, capital adequacy, asset/liability management, competitive landscape and regulatory environment. These risks inform our credit forecasts, which can be stress tested for sufficiency of capital and to determine the risk of a future liquidity event. Our downside loss scenarios are then used to determine how much additional degradation would need to occur in order to create capital issues, which could necessitate a potentially dilutive capital event, and drive absolute downside to our entry point.

Despite a challenging quarter, it continues to be our view that the banking industry is structurally improving. We believe that the elimination of irrational competitors and a return to more economic pricing of credit risk will lead to structurally higher returns for those companies (i.e., Relationship Lenders) that we believe are best positioned to weather the current economic environment. In addition, we expect that the better positioned banks will garner significant market share from weakened competitors. In general, we believe that valuations within financials remain relatively attractive. Looking forward, we would expect the portfolio to continue to favor banks and life

insurance vs. REITs and property & casualty insurance. With returns on new business improving at select banks and life insurance companies, we remain interested in those companies that possess sustainable longer term business models, while seeking to purchase our stake at levels that we believe provide us with an asymmetric risk / reward profile.

### ***Consumer, Business Services, Health Care, and Technology***

We continue to allocate capital toward companies with less cyclical exposures that are undergoing company-specific changes that we believe will lead to improving returns. We remain cautious regarding more discretionary consumer-related businesses as we feel that these companies face ongoing challenges due to the high levels of unemployment, increased savings rates, and depressed home valuations. With the U.S. government having propped up the mortgage market, we remain defensively positioned with respect to the consumer as we await further visibility regarding what impact the withdraw of this artificial support will have. Therefore, to the extent that we make investments that are impacted by the consumer, we seek businesses that serve less discretionary needs or have more recurring cash flow characteristics.

As detailed in last quarter's commentary, healthcare has been an area where we have been especially active in allocating capital. As the impact of healthcare reform becomes clearer, we believe that winners and losers will emerge. As such, we continue to allocate capital to those companies that should benefit from the incremental 30 million new insured lives in the United States, after taking into account any incremental taxes or other reform-related costs that might be borne by the business. Within business services and technology, we continue to allocate capital to businesses that have maintenance-type revenue streams with high renewal rates and recurring cash flow businesses that we believe will thrive, even under softer economic conditions. As such, we feel that we are well positioned for whatever unfolds with the broader economy.

### ***Hard Assets***

The hard assets pod is divided between businesses that we generically label as "industrials" and those falling under the natural resource heading. The primary difference between the two groups relates to the laws of mean reversion. In industrials, processing and service oriented businesses excess returns are typically competed away over time, which is why we focus on *improvements* in returns on invested capital when assessing investment opportunities. In contrast, our view is that returns on capital in the natural resource space are a function of where a company's producing assets sit on a supply cost curve. Effectively, we believe that returns are typically driven by the "quality of the rock" and, because geology doesn't change over our 3-5 year investment time horizon, returns on capital in the natural resource space are not often subject to mean reversion. Due to this fundamental difference, we believe that each segment deserves its own separate commentary.

### ***Industrials***

While the operating environment for many industrial companies has improved over the past year, we remain concerned about most companies' ability to generate positive pricing in an environment where significant excess labor and manufacturing capacity persists. As a result, we have slanted our exposure towards what we believe to be the higher quality, more durable franchises within the industrial landscape. We like purchasing these businesses at steep discounts to warranted value, as we believe that our downside risk remains limited. Moreover, we remain convinced that the opportunity to own defensible, differentiated business models, run by outstanding management teams, will set the foundation for attractive future returns.

### ***Natural Resources***

Our objective in managing investments within natural resources is to optimize risk adjusted returns across a full commodity price cycle. An important part of our process involves visiting various natural resource projects around the world. We do this to gain perspective on how future projects will impact

the supply cost curve for a commodity and to identify the owners of what we believe are the most cost advantaged projects in a given commodity. Importantly, we believe that this work provides us with a basis for assessing current and future incentive prices for various commodities, as well as helping us in our efforts to generate project-by-project net asset value models for the companies we own. We believe that the best way to generate superior through-cycle returns for our investors is by:

1. Owning only those low-cost, advantaged producers of commodities (“advantaged” in the sense that the companies own assets that sit at the bottom of a steeply sloped supply cost curve and can earn excess returns on capital, independent of the commodity cycle);
2. Investing in advantaged companies that have management teams focused on generating returns that exceed their cost of capital irrespective of commodity price;
3. Limiting sovereign and geological risk; and
4. Purchasing stakes in these few advantaged producers only when we believe that their share prices are trading below net asset value.

We believe that the current environment for natural resources is mixed and that in the absence of a coordinated pick-up in global demand, commodity prices will continue to oscillate around their respective incentive prices with a high degree of volatility. We will use short-term dislocations between price and underlying economic value to establish positions in the most advantaged assets at reasonable prices, and will conversely use periods of strength to reduce exposure to businesses when valuations look stretched. As such, our portfolio turnover may pick up slightly versus historical levels, although our name turnover likely will remain quite low.

The longer-term outlook for natural resources remains positive, in our view. Supply costs for many commodities continue to rise for geological reasons, excess capacity remains relatively low, the longer-term demand trends from emerging market countries remain favorable, and the risk of inflation in basic commodities continues to rise. Our objective is to continue to expose our investors to what we believe are the most advantaged natural resource companies across the commodities spectrum when valuations are attractive. By doing so, we strive to provide our investors with all the benefits associated with an investment in the natural resource space, while seeking to mitigate the associated risks.

### **Outlook**

We are neither macro economists nor top-down investors. However, we believe that we are in a period of protracted volatility as the markets continue to grapple with a variety of issues, including ongoing deleveraging, deflation/inflation risks, government budget deficits, higher taxes, and the potential for rising risk premiums. We remain cautious with respect to the levels of financial and operational leverage that we will tolerate within our portfolio companies. We have never attempted to maximize short-term results, as we do not believe that our investors would be adequately compensated for the level of risk that we would have to assume.

With the possibility for increasing interest rates, inflation, risk premiums and taxes conspiring to raise the market discount rate, we believe that markets may remain under pressure for some time. As business analysts, we enjoy fundamentally-driven environments where company-specific structural changes and improvements in cash flow returns on invested capital are the primary determinant of investment results. We firmly believe that the strength of our team, a consistent and repeatable process, and a realistic investment horizon are critical factors in generating superior long-term, risk-adjusted returns for our clients.

We thank you as always for your ongoing support.

Sincerely,



MacKenzie Davis, CFA



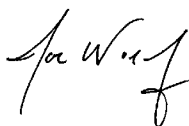
David Kelley



Andrew Pilara



Ken Settles, CFA



Joe Wolf

As with all mutual funds, the value of an investment in the Fund could decline, so you could lose money. The Fund invests primarily in equity securities and therefore exposes you to the general risks of investing in stock markets. 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.

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 June 30, 2010.

***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](http://www.RSinvestments.com).***

#### **Appendix – Stock Examples**

**Hasbro** (HAS, 4.5% as of 6/30/2010), the world's second largest toy and game manufacturer, has been a top performer this year. The Company is in the early stages of extending its valuable brand portfolio beyond traditional toy markets and into movies, television, video games, and mobile applications. We believe that this strategy, which is similar to the one successfully executed by Marvel over the last 5-10 years, will transform Hasbro from a toy manufacturer heavily reliant on 3<sup>rd</sup> party license agreements to more of a brand management/media company with a vast portfolio of valuable intellectual property. This should result in larger and more diverse revenue streams with less seasonality, higher margins, more attractive returns on capital, and significantly less risk when compared with the current business model. We initiated our investment in the third quarter of last year as we felt that the market failed to appreciate the enormous value of Hasbro's intellectual property or the significant earnings acceleration that we expect will occur beyond 2010.

Historically, this has been a high-quality business, with double digit EBIT margins and returns on capital in the mid-teens. Hasbro's strong competitive position and the relatively defensive nature of the toys category make the business highly durable. Hasbro's core business will benefit from retailers like Wal-Mart and Target reducing their number of SKUs while allocating greater shelf space to larger manufacturers with strong media-backed consumer brands, sophisticated sourcing/manufacturing infrastructures, and the ability to navigate increasingly onerous safety regulations. With only a 10% share of the domestic toy industry, we believe that Hasbro has room to

grow despite the maturity of the overall market. Hasbro is also the beneficiary of an attractive 2011-2012 movie release schedule, anchored by Transformers 3, Spider-Man 4, Captain America, and Thor and supported by several movies based on Hasbro brands, including Monopoly, Stretch Armstrong, and Battleship. Hasbro also has a partnership with Electronic Arts to make video games and mobile phone applications based on Hasbro brands.

Another opportunity for Hasbro that we are encouraged by will come later this year with the re-launch of the Discovery Kids cable network, in which Hasbro invested \$300 million to acquire a 50% ownership interest. Hasbro's apparent foray outside of its core toy business has been a source of concern for some investors; however we believe that this was a shrewd investment for Hasbro. At worst, we believe that this will prove to be a valuable strategic asset and, if things go well, it could generate very attractive returns on a stand-alone basis. Discovery Kids is distributed in approximately 60 million homes and at the time of acquisition was generating about \$50 million of revenues and \$25 million of EBITDA. Viewership was low (it is not currently Nielson-rated) as the programming was focused on education more than entertainment. The plan is to re-launch the channel in the fall of this year with a new name ("The Hub") and new programming centered on Hasbro brands. On a stand-alone basis we feel that there is a huge opportunity to improve the operating and financial metrics and increase the value of the channel. Monthly subscription fees are approximately \$0.06 vs. ~\$0.16 for Cartoon Network and ~\$0.44 for Nickelodeon, both of which are fully-distributed (~95mm-100mm homes). Advertising revenues are only ~\$5 million (10% of revenues) vs. estimates for Cartoon Network of \$350 million (58% of revs) and \$1 billion for Nickelodeon (50% of revs). While there may be a lot of execution risk associated with this investment, our view is that by creating higher-quality programming based on well-known brands, the network can improve its ratings, leading to higher advertising revenues and, over time, higher affiliate fees. In addition, having ownership/control of a broadly-distributed kids network could be a valuable piece of the overall Hasbro strategy of increasing the value of its owned brands. Successful franchises like Power Rangers and SpongeBob were launched on television and for other brands like Transformers and Star Wars, television generates incremental licensing revenues and keeps the brand in front of the consumer in non-movie years. Television shows also drive toy sales – Hasbro believes that it can generate "hundreds of millions of dollars" of incremental toy sales as a result of its Discovery investment. Without control of a network, Hasbro would have trouble obtaining the programming schedule needed to effectively build its brands.

Expanding share in the rapidly growing international markets will also be an important revenue driver for Hasbro. According to a recent Keybanc report, the international toy market has experienced a five-year growth rate that is 8X that of the domestic market, yet industry penetration in these markets is still well below the U.S. While Hasbro generates a much smaller percentage of its sales outside of the U.S. compared to its largest competitor (34% vs. 47% for Mattel), the Company is working on closing this gap by investing heavily in building out its sales and distribution infrastructure in rapidly growing emerging markets. We remain very excited about our investment in Hasbro as we do not think the market fully appreciates the significant structural changes going on at the company or the positive impact that they will have on returns. Moreover, in spite of its strong performance this year, we believe that Hasbro remains reasonably valued.

We remain very constructive on the long-term outlook for our investment in **AFLAC Inc.** (AFL, 2.7% as of 6/30/2010) despite its negative contribution to second quarter performance. In fact, we used weakness during the quarter to increase our overall position size, as we believe that we are purchasing one of the more attractive business models within financials with limited downside risk over our investment horizon. AFLAC is one of the largest underwriters of supplemental disability and health insurance in Japan and the United States, with nearly 75% of its cash flows generated from Japanese operations. AFLAC controls over 50% of the Japanese supplemental health market and is 12X larger than its nearest competitor. The Company maintains its dominant position because dedicated agents are imbedded within Japanese corporations, providing what we believe to be a

significant “moat” around AFLAC’s business. This has allowed the Company to not only maintain extremely high returns, but has also allowed it to add additional products at even higher returns on invested capital.

Over the last seven years, AFLAC has leveraged its distribution capabilities and shifted its product mix in Japan from offering supplemental cancer insurance (which generates low 20% ROEs) to offering supplemental medical coverage, which generates returns closer to 40%. We believe the shift will continue given that the Japanese public healthcare system is under significant pressure and coverage is being reduced, leading to an ever increasing demand for private market supplemental healthcare products. Given the dynamics of an aging Japanese population and shrinking workforce, we believe that demand for supplemental health coverage will continue to increase over time.

Shares of AFLAC came under pressure during the quarter due to the company’s exposure to sovereign debt held in its investment portfolio. Because of the lack of a significant long duration corporate bond market in Japan, AFLAC holds bonds and debt from other geographic regions. AFLAC’s shares declined due to concerns raised regarding its \$270M in Greek sovereign debt investments as well as holdings in other stressed European countries. Yet AFLAC remains flush with excess capital, continues to generate nearly \$2 billion annually in free cash flow, and in our view, could write its entire exposure to Europe down to zero and still remain well-capitalized. In fact, the company recently announced the sale of its entire Greek exposure, resulting in a one-time loss of just \$67 million. Given our view of this as a positive result, we believe that the company’s exposure to losses on its investment portfolio is very manageable and remain confident that management will be able to continue to generate improving returns resulting from the successful mix shift toward higher-return supplemental health products.

**Sector Allocation<sup>2</sup>**  
(As of 6/30/10)

Financial Services	28.91%
Energy	13.10%
Health Care	12.21%
Technology	10.71%
Materials & Processing	10.70%
Consumer Discretionary	10.37%
Producer Durables	5.67%
Consumer Staples	3.01%
Cash	5.32%

**Top Ten Holdings<sup>3</sup>**  
(As of 6/30/10)

Hasbro, Inc.	4.49%
Citigroup, Inc.	4.29%
Praxair, Inc.	4.23%
Fidelity National Information Services, Inc	4.16%
Agilent Technologies, Inc.	3.73%
Merck & Co., Inc.	3.48%
Pfizer, Inc.	3.48%
Martin Marietta Materials, Inc.	3.41%
Activision Blizzard, Inc.	3.28%
Southwestern Energy Co.	3.26%

## Performance

(Average Annual Total Returns as of 6/30/10)

	Second Quarter 2010	1-Year	3-Year	5-Year	10-Year	Since Inception <sup>4</sup>
RS Large Cap Alpha Fund, Class A without sales charge	-10.51%	15.77%	-5.33%	3.86%	-3.10%	11.54%
with maximum sales charge	-14.76%	10.27%	-6.85%	2.85%	-3.57%	11.40%
Russell 1000 <sup>®</sup> Value Index <sup>1</sup>	-11.15%	16.92%	-12.32%	2.85%	2.38%	N/A
S&P 500 <sup>®</sup> Index <sup>5</sup>	-11.43%	14.43%	-9.81%	-0.79%	-1.59%	9.45%

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

The Fund is the successor to the Guardian Park Avenue Fund, a mutual fund with substantially similar investment objective, strategies, and policies. The performance of the Fund provided in the chart includes that of the predecessor fund prior to October 9, 2006. 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 Fund's total gross annual operating expense ratio as of the most current prospectus for the Class A Shares is 1.04%. Please refer to the most current Fund prospectus for complete details on expenses including fees. The performance quoted, "with maximum sales charge" reflects the current maximum sales charge of 4.75% that became effective on October 9, 2006. 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](http://www.RSinvestments.com).

**1** The Russell 1000<sup>®</sup> Value Index is an unmanaged market-capitalization-weighted index that measures the performance of those companies in the Russell 1000<sup>®</sup> Index (which consists of the 1,000 largest U.S. companies based on total market capitalization) with lower price-to-book ratios and lower forecasted growth values. Index results assume the reinvestment of dividends paid on the stocks constituting the index. Unlike the Fund, the index does not incur fees or expenses.

**2** The Fund's holdings are allocated to each sector based on their Russell classification. If a holding is not classified by Russell, it is assigned a Russell 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.

**4** Class A shares inception date June 1, 1972.

**5** The S&P 500<sup>®</sup> Index is an unmanaged market capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Index results assume the reinvestment of dividends paid on the stocks constituting the index. You may not invest in the index, and, unlike the Fund, the index does not incur fees and expenses.

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