

## Second Quarter 2011 Mutual Fund Commentary RS Small Cap Growth Fund

### Market Commentary

Equity markets delivered mixed performance in the second quarter of 2011 as signs of weakening U.S. economic growth and concerns over the ongoing debt crisis in Europe dampened investors' risk tolerance. Adding to the climate of uncertainty was the winding down of the Federal Reserve's second round of quantitative easing, or QE2, which had helped to boost market liquidity since its launch late last summer. Against this backdrop, investors sought relative safety in the more traditionally defensive sectors such as consumer staples, healthcare, and utilities, which all performed well within the Russell 2000<sup>®</sup> Index<sup>1</sup>. Additionally, in a reversal from the first quarter, higher-beta stocks underperformed within the small cap market as higher-quality companies, characterized by higher returns-on-equity, performed well.

### Performance Review

For the three-month period ended June 30, 2011, RS Small Cap Growth Fund (Class A Shares) returned 3.48%, outperforming a -0.59% return by the benchmark Russell 2000<sup>®</sup> Growth Index<sup>2</sup>. Stock selection was especially favorable in the consumer discretionary and health care sectors. On a negative note, the Fund's stock selection in the utilities and technology sectors detracted from performance relative to the index.

### Portfolio Strategy

RS Small Cap Growth Fund is managed according to our philosophy that long-term share price appreciation is driven by sustainable earnings growth. We are focused on companies whose core business can transition them from being a small market-cap company to a mid- or even large-capitalization company over time. We seek companies with innovative products or services that are growing organically, creating new markets or taking market share away from existing companies, focusing on those that we believe will achieve high margins, high returns on equity, and a subsequent appreciation in business value regardless of the underlying market environment.

The Fund is managed by four co-portfolio managers who also serve as sector specialists. The core of our team has worked together for over ten years. We conduct over 2,000 company meetings each year, through in-person meetings, conference calls, trade shows, etc. We then back up our findings through discussions with industry leaders and third-party sources, as well as through proprietary financial modeling.

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 1.47%. 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).

We are long-term investors and seek to establish definable “anchor points,” or quantifiable metrics indicating a company’s long-term growth trajectory. “Anchor points” allow us to maintain our research focus as a company executes its business strategy. We find these tools invaluable in aligning our research with management’s stated goals and in preventing distraction caused by short-term stock price movements and inevitable market volatility.

In constructing the portfolio, we combine investments in companies with established business models and demonstrated financial success with exposure to promising and developing companies that are in the earlier stages of their growth cycle. We believe that this multi-tiered approach allows us to capitalize on the growth potential across the small cap spectrum, while also managing risk and ensuring a well diversified portfolio for our investors.

With respect to risk, we seek a *minimum* two-to-one ratio of upside potential to downside risk potential for each investment over 12-18 months. We measure these scenarios using proprietary financial models that look not one or two quarters out, but rather three to five years out, focusing on the anchor points that we define for each business. At the portfolio level, we conduct weekly formal risk-management meetings.

### **Portfolio Review**

During the second quarter, several of our consumer discretionary holdings positively contributed to the Fund’s relative performance. Our anchor points for companies in the consumer sector typically focus on the size and growth potential of the addressable market and, specifically, the company’s increasing share of that market. Within the retail segment, for example, we assess metrics such as improvements in store traffic, sales comparisons, and profit margins, modeling our view of a company’s sustainable growth potential three to five years out.

Two consumer discretionary companies in the developing category that positively contributed to Fund performance during the quarter were retailers Ulta Salon, Cosmetics & Fragrance (1.75% position as of 6/30/2011) and Vitamin Shoppe (1.59%).

Ulta Salon, Cosmetics, & Fragrance continues to report solid revenue performance as it capitalizes on its store expansion plans and unique retailing strategy. Our investment thesis for the company centers on square footage growth and expanding margins that should translate into strong earnings per share growth for the future. Ulta has approximately 10% market share in the \$10 billion specialty retail market and our analysis suggests that its market share could be much greater. The company attracts more customers to its stores, luring them away from department stores and other incumbents, by carrying a broad range of beauty and salon products, from discount lines to higher-end brands. Revenue growth has been driven by traffic, rather than just by raising prices, a trend that we find to be favorable among retailers.

Vitamin Shoppe, a retailer that sells vitamins and other supplements primarily in off-mall street locations, was another positive contributor. Vitamin Shoppe has been able to draw customers away from drug stores and other retailers through its strong customer service strategy which results in higher repeat purchases and a greater number of touchpoints with customers. Our investment thesis for the company focuses on its ability to have a larger assortment than most specialty retail and drug stores due to scale as well as its ability to leverage its fixed cost infrastructure. The company has made significant investments in information technology to allow the company to better manage inventory which will ultimately increase long term margins. We are also positive on recent management upgrades with a new CIO; VP of product development who came from competitor GNC (0.00%); and a VP of store operations who joined from Toys R Us (0.00%). We believe that both Vitamin Shoppe and Ulta are well-positioned for long-term growth as they continue to expand their store bases, gain market share, and potentially realize growth in excess of market expectations. We

will continue to closely monitor each business' progress against our anchor points that we believe they are able to achieve.

We also continue to find opportunities in health care, where we look for innovative companies that we believe can grow in a new healthcare landscape characterized by rising healthcare costs, an aging population, and the emergence of 30 million newly insured healthcare participants created under healthcare reform. We also look for companies that we believe are less susceptible to some of the sector's risks such as regulatory, event, reimbursement, and development risks, combining investments in promising companies that are early in their growth curve with holdings in developing and proven companies that have a more established platform of products and services and have demonstrated financial performance.

One of the Fund's promising biotechnology holdings that contributed to Fund's relative performance both in the second quarter and year-to-date was Pharmasset (1.00%). The company focuses on developing next generation treatments for hepatitis C (HCV), a condition that affects at least 4 million people in the United States, making the addressable market quite large. The existing treatment regimen for HCV relies heavily on the use of interferon, a toxic substance with significant side effects. Additionally, less than 3% of total HCV sufferers in the U.S. are currently receiving treatment for the disease. Against this backdrop, we believe that there is a huge potential market for Pharmasset's next generation, interferon-free drugs which are given orally rather than intravenously, and the company has continued to progress towards our long term anchor points.

In the technology sector, we continue to find innovative companies that we believe will benefit from the secular shifts taking place, including the massive adoption of consumer technologies as well as enterprise technologies that serves to make businesses more efficient and competitive. During the second quarter, however, several of our investments in the sector came under pressure as technology companies overall underperformed largely due to macroeconomic concerns and investor preference for more traditionally defensive sectors of the market.

One company that detracted from Fund returns during the quarter was a developing company, Oclaro (0.85%), a supplier of optical components used in switches, routers, and other networking equipment. Oclaro ties into our long-term thesis regarding opportunities created by the build-out in network capacity. Given the increasing popularity of streaming video, audio, and remote applications, networking giant Cisco Systems (0.00%) projects that data traffic could grow 30 times by 2015. Cisco also highlights that by 2015, 1 million video minutes -- the equivalent of 674 days -- will traverse the Internet every second. These structural changes support our view that massive continued investment in new capacity to handle this traffic will be required. We believe that this will benefit networking equipment manufacturers, as well as companies that make processors and components integral to this equipment. Oclaro underperformed during the quarter after too many components were shipped to its customers, setting the stage for an inventory correction that dampened its near-term earnings prospects. We believe this to be a near-term non-fundamental issue. Our ongoing monitoring of the company's business versus our anchor points supports our investment thesis and gives us the confidence to hold onto the position despite this temporary inventory issue.

Within technology, another area where we continue to see significant opportunity is in the LED lighting technology market. Currently, this technology is the standard for most computer and smart phone screens, as well as for HDTV panels. Given the tremendous long-term cost savings and energy efficiency of this technology, we believe that they will eventually be widely adopted across the \$20 to \$30 billion general lighting market, with applications in everything from automotive dashboards to industrial and commercial lighting. We recognize that one hurdle to wider adoption of this technology has been the higher initial price of LEDs. Recently, weaker-than-anticipated consumer demand has resulted in some inventory building and price discounting in the LED market,

dampening earnings performance for a number of LED technology companies, including SemiLEDs (0.69%), a promising company that supplies LED chips and components used in a variety of general lighting applications. As a result, shares sold off in the second quarter. Nonetheless, we believe that this price discounting will actually help to speed adoption of this technology and eventually work in favor of wider LED adoption and SemiLEDs' long-term growth potential.

While most of our technology holdings continued to progress towards our long term anchor points despite some pressure during the second quarter, one company, Smith Micro Software (0.00%), failed to progress towards our investment thesis. Smith Micro is a maker of wireless Internet connectivity software for cellular phones that has continued to experience inventory building by their largest customers. Factors including big customer Verizon's (0.00%) slower-than-expected roll-out of 4G wireless technology, as well as the company's ability to execute on its business model, have created uncertainty around the company's long-term prospects and ability to expand market share. While we continue to view the rollout of 4G technology favorably, we chose to exit the position.

### Outlook

As we look ahead, we remain cautiously optimistic on the outlook for our portfolio of companies as they continue to maneuver through a backdrop of continued mixed signals in the global economy. We acknowledge that risks associated with volatile energy prices and an unwinding of the Fed's recent quantitative easing could contribute to renewed market volatility and create headwinds for certain businesses. Overall, we believe that small cap companies house some of the most compelling innovations and we continue to focus on high-quality companies that we believe will realize sustained earnings growth. As long-term investors, we are looking beyond short-term cyclical factors and positioning the Fund to benefit from innovations and secular growth opportunities across a variety of industries.

Thank you for your continued investment.

Sincerely,



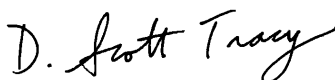
Steve Bishop  
Co-Portfolio Manager



Melissa Chadwick-Dunn  
Co-Portfolio Manager



Allison Thacker  
Co-Portfolio Manager



D. Scott Tracy, CFA  
Co-Portfolio Manager

As with all mutual funds, the value of an investment in the Fund could decline, so you could lose money. Investing in smaller companies can involve risks such as having less publicly available information, higher volatility, and less liquidity than in the case of larger companies. Overweighting investments in certain sectors or industries increases the risk of loss due to general declines in the prices of stocks in those sectors or industries. Investments in technology companies may be highly volatile.

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

### **Sector Allocation<sup>3</sup>**

(As of 6/30/11)

Consumer Discretionary	21.85%
Health Care	19.91%
Technology	19.86%
Producer Durables	14.01%
Financial Services	7.87%
Materials & Processing	7.38%
Energy	4.27%
Consumer Staples	1.16%
Utilities	1.15%
Cash	2.54%

### **Top Ten Holdings<sup>4</sup>**

(As of 6/30/11)

Ulta Salon	1.75%
HEICO Corp.	1.70%
Netlogic Microsystems, Inc.	1.60%
Vitamin Shoppe, Inc.	1.59%
Steven Madden Ltd.	1.55%
RBC Bearings, Inc.	1.53%
Wright Express Corp.	1.53%
Gardner Denver, Inc.	1.51%
Team Health Holdings, Inc.	1.51%
Ancestry.com, Inc.	1.49%

## Performance

(Average Annual Total Returns as of 6/30/11)

	Second Quarter 2011	1-Year	3-Year	5-Year	10-Year	Since Inception <sup>5</sup>
RS Small Cap Growth Fund, Class A						
without sales charge	3.48%	47.73%	11.06%	7.07%	2.72%	13.68%
with maximum sales charge	-1.42%	40.76%	9.27%	6.04%	2.22%	13.44%
Russell 2000 <sup>®</sup> Growth Index <sup>2</sup>	-0.59%	43.50%	8.35%	5.79%	4.63%	8.54%

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

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**1** The Russell 2000<sup>®</sup> Index measures the performance of the 2,000 smallest companies in the Russell 3000<sup>®</sup> Index, which consists of the 3,000 largest U.S. companies based on total market capitalization. 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 Russell 2000<sup>®</sup> Growth Index is an unmanaged market-capitalization-weighted index that measures the performance of those companies in the Russell 2000<sup>®</sup> Index with higher price-to-book ratios and higher forecasted growth values. (The Russell 2000<sup>®</sup> Index measures the performance of the 2,000 smallest companies in the Russell 3000<sup>®</sup> Index, which consists of the 3,000 largest U.S. companies based on total market capitalization.) 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, it does not incur fees and expenses.

**3** 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.

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

**5** Class A shares inception date November 30, 1987.

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