

## Second Quarter 2011 Mutual Fund Commentary RS Value Fund

### Philosophy and Process

We believe that company-specific value creation is often mispriced in the public markets and, as such, we have built a team of investment professionals who employ a research process that is private equity-like in nature. As business analysts, we are interested in understanding how companies create value over time. We work in teams, dissecting businesses into their component parts to gain insights into how and where capital is being allocated, and the cash flows and returns associated with those capital decisions. As value investors, we believe that capital preservation is the key to long-term wealth creation, and only deploy our shareholders' capital when we feel that the purchase price available in the market provides us with what we view as a reasonable risk profile. We acknowledge that investment returns are a function of entry price and, as such, we define risk as the permanent impairment of our clients' wealth, as opposed to stock price volatility. We acknowledge that over short periods of time we may under perform a benchmark, but believe that our differentiated team structure, philosophy and process will continue to provide us with the opportunity to generate superior risk-adjusted returns over a reasonable investment timeframe.

### Performance Update

For the second quarter of 2011, RS Value Fund (Class A Shares) generated a return of -2.29% versus -0.69% for the benchmark Russell Midcap<sup>®</sup> Value Index<sup>1</sup>. Technology and Materials & Processing were the Fund's two best performing sectors during the second quarter, led by Symantec (a software and services provider of security, storage and systems management solutions) and Praxair (a supplier of industrial gases), respectively. Financial Services was the sector primarily responsible for the Fund's relative underperformance during the quarter. Within Financials, insurance with exposure to Japan and select banks led the underperformance. In addition, the Fund's underweight to both Utilities and Consumer Staples weighed on quarterly performance as investors sought shelter within these sectors during the quarter.

Year-to-date, the Fund posted a return of 1.89% versus 6.69% for the benchmark. Like the quarter, Technology and Materials & Processing were the Fund's two best performing sectors during the first six months of 2011. Within Technology, Atmel Corp (4.34% position as of 6/30/2011, a provider of semiconductors and touch solutions, primarily used in mobile devices) and Symantec (3.43%) led

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 1.41%. 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).

performance while Praxair (4.39%) and Eastman Chemical (2.62%) were the top performers within Materials and Processing. Conversely, Financial Services and Energy were the two sectors that most negatively impacted the Fund's relative performance for the year-to-date period. Within Financials, First Horizon National Corp. (2.87% a regional commercial bank focused on the Southeastern United States) and AFLAC Inc. (3.63%, a supplemental insurance provider to individuals in the U.S. and Japan) were the two biggest laggards. In addition, negative absolute returns were generated by Talisman Energy (3.72% an international oil and gas producer) and Peabody Energy Corp (2.43% a global thermal and metallurgical coal miner), which weighed on the Fund's performance within the Energy sector. (Please see "Appendix- Stock Examples" below for additional commentary on both AFLAC and Talisman.)

While we are disappointed with the Fund's absolute and relative performance during the first six months of the year, we remain committed to our core philosophy and are using the current market environment to selectively deploy capital. We believe that our process has proven itself over time, and it is something that we continue to believe provides us with a useful framework with which to prudently manage our clients' capital, as well as our own.

## **Portfolio Positioning**

### ***Financials***

Broadly speaking, within the financial services sector, we continue to see evidence that delinquencies have peaked and that the credit fire is in the process of burning itself out. Moreover, capital and liquidity are more than sufficient at many companies, and material changes to underwriting standards should lead to higher risk-adjusted returns for the industry. That said, we have been quite discriminating in our investments within financials, concentrating our holdings primarily in insurance companies and banks with what we view as advantaged business structures. These include insurance companies with structurally superior distribution models as well as banks focused on "relationship lending" that possess low cost core deposit franchises. We continue to believe that these business models will generate superior risk-adjusted returns over our longer-term investment time horizon.

Within insurance, we have a sizeable position in AFLAC Inc., a company that generates over 70% of its cash flows from Japan. This year, the shares of AFLAC have been under considerable pressure as a result of investor concerns related to: 1) the Tohoku earthquake and ensuing tsunami that hit Japan in March, and 2) the short-term ramifications related to the company's decision to de-risk its investment portfolio. We firmly believe that the tragic events of March 11, 2011 will not have a material impact on the overall long-term return profile of the business. In addition, the company's announcement in May that it will sell some of its European sovereign debt holdings does not change our investment thesis. Although these actions will put near-term pressure on returns, we believe that reducing risk is in the long-term best interests of shareholders and that said actions will not materially impact either the company's capital levels or returns over our investment time horizon. In fact, we used recent stock price weakness as an opportunity to add to our position in AFLAC. (Please see "Appendix- Stock Examples" below for additional commentary on AFLAC.)

Recall that we increased the Fund's exposure to banks in late '09/early '10 as we became more constructive on the sector. During this period, we deployed capital toward those businesses that we felt possessed solid capital positions, stable and reliable funding sources, strong management teams, increasing returns on invested capital, and a favorable risk/reward profile over our three year investment horizon. We continue to believe that the banking industry is undergoing significant structural change, accreting value to traditional relationship-focused franchises. We believe that the elimination of irrational competitors and a return to more economic pricing of credit risk will lead to structurally higher long-term risk-adjusted returns for these franchises. In addition, we expect that the better positioned banks will garner significant market share from weakened and sub-scale competitors. Importantly, while we see signs that credit losses may have peaked, our investment

thesis does not rely on improving trends, as our downside analysis continues to assume a significant degradation in credit, as well as an extended period of muted loan growth.

In general, valuations within financials remain attractive. Looking forward, we would expect the portfolio to continue to favor banks and insurance companies. With returns on new business improving at select banks and insurance companies, we remain interested in those companies that possess sustainable longer term business models, while also seeking to purchase our stakes at levels that we believe provide an extremely favorable entry point.

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

In last quarter's commentary, despite evidence suggesting a modest improvement in the unemployment picture domestically, we expressed our concerns about the fragile nature of the US consumer. As such, we remained cautious and selective with regard to our consumer discretionary investments. During the second quarter, the market appeared to wake up to some of these concerns, and we used market weakness as an opportunity to add incremental capital to both existing positions as well as to select what we view as high-quality consumer discretionary positions. As always, we seek to invest in companies undergoing company-specific structural change that can lead to an improvement in the Return on Invested Capital (ROIC) profile of the enterprise, irrespective of broader trends in general economic activity.

In addition, healthcare continues to be an area where we have been active in searching for new opportunities. As the impact of healthcare reform becomes clarified, we believe winners and losers will emerge. As such, we continue to allocate capital to those companies that we believe should thrive under different health care reform scenarios. Within business services and technology, we continue to allocate capital to businesses that have understandable and predictable revenue streams with high customer retention rates and recurring cash flow characteristics. As such, we believe that the Fund is appropriately positioned for whatever unfolds within the broader economy.

### ***Hard Assets***

The hard asset pod (sector grouping) is divided between businesses that we generically label "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, 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, returns are 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 tend not to mean revert over time. As a result, in the natural resource space we use short-term volatility, often driven by changing expectations regarding near term commodity price movements, to establish positions in businesses that we believe are structurally advantaged, both in-terms of asset quality and management's capital allocation acumen. Due to this fundamental difference, 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 a world where significant excess labor and manufacturing capacity persists. As a result, we have slanted our exposure towards what we view as the higher quality, more durable franchises within the industrial landscape. When we can buy these businesses at what we view as reasonable prices given our estimation of downside, and estimate equity returns based on company specific initiatives, we deploy our clients' capital.

### *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 current net asset value.

The commodity complex has come under pressure over the last several weeks given concerns related to the outlook for demand in both developed and developing economies. We are not economists and our guess regarding near-term demand trends is likely no better than anyone else’s. However, we remain confident that the longer-term outlook for commodities is intact, driven primarily by limited spare capacity and rising marginal costs of supply. Thus, while commodities like oil and silver may drop in price due to proposed reserve releases or changes in margin requirements, we believe that these short-term price movements provide patient, long-term investors with opportunities to deploy capital into those producers of commodities that are temporarily out of favor. In addition, while commodities like copper and gold continue to trade above our assessment of sustainable price levels, the related equities are discounting more attractive long-term prices. We believe that markets such as these, characterized by volatility and frequent discrepancies between asset value and stock prices, are attractive environments in which to deploy capital.

We believe 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 attempt to use short-term dislocations between price and underlying economic value to establish positions in what we believe to be 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 turnover in the Fund may pick up slightly versus historical levels, although our turnover with respect to companies held in the Fund 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 shareholders to the most advantaged natural resource companies across the commodities spectrum when valuations are attractive. By doing so, we believe that we are best able to provide our investors with all the benefits associated with an investment in the natural resource space, while also mitigating the associated risks. As long term investors, we believe that these are the markets that establish the foundation for strong future returns, and we are excited about the prospects moving forward.

## Outlook

We believe that we are in a period of protracted volatility as the markets 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 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. As business analysts, we enjoy fundamentally-driven environments where company-specific structural change 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 have put us in a position to benefit long-term investors. Moreover, we think that the Fund is very well positioned for an environment where individual company-specific cash flow fundamentals are properly rewarded.

We are, as always, thankful for your patience and support.

Sincerely,



MacKenzie Davis, CFA



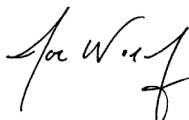
David Kelley



Andy 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. Investing in small- and mid-size companies can involve risks such as having less publicly available information, higher volatility, and less liquidity than in the case of larger companies. Investing in a more limited number of issuers and sectors can be subject to greater market fluctuation. 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. Foreign securities are subject to political, regulatory, economic, and exchange-rate risks not present in domestic investments. 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. Investments in companies in natural resources industries may involve risks including changes in commodities prices, changes in demand for various natural resources, changes in energy prices, and international political and economic developments.

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).***

## Appendix – Stock Examples

We remain very constructive on the long-term outlook for our investment in **AFLAC Inc.** (AFL, 3.63% position as of 6/30/2011), despite its negative contribution to second quarter and year-to-date performance. In fact, we used recent weakness to increase our overall position size, as we believe that we are purchasing one of the more attractive business models within financials at a highly compelling valuation. Headed by its disciplined CEO, Dan Amos, AFLAC is one of the largest underwriters of supplemental health coverage in Japan, and also maintains a significant presence in the United States. The company generates over 70% of its cash flows from Japan, where it offers low-premium, fixed-benefit supplemental medical, cancer and life insurance coverage. In Japan, AFLAC controls approximately 50% of the supplemental health market and is 12X larger than its nearest competitor. AFLAC's affiliated corporate agency business model (where dedicated agents are embedded in over 90% of the 2,000+ companies listed on the Tokyo Stock Exchange), coupled with its lucrative distribution agreements with most Japanese banks, provides the Company with material pricing power and a significantly higher return profile relative to its peers. This advantaged structure also allows the Company to successfully sell new products to its existing customer base at even higher returns on invested capital. Because AFLAC's products typically are low cost, paid through direct deposit, and are viewed as a necessity in order to confront rising healthcare costs in Japan, persistency rates exceed 90%, providing AFLAC with tremendous stability in its cash flows.

With an aging population and a declining birthrate, Japan is in the midst of a significant population decline that is taxing its national health care system. As a consequence, the Japanese government is cutting reimbursement levels to individuals, resulting in increased out-of-pocket expenses for its citizens, which, in turn, forces them to seek alternatives for bridging this growing gap in coverage. Given that the Japanese public healthcare system remains under significant pressure, we believe that this trend toward reduced coverage will continue, fueling increased demand for private market supplemental healthcare products. With AFLAC's advantaged distribution model and scale efficiencies, the company enjoys a material cost advantage relative to its competitors. For example, with over 2000 corporate agents, and operations in 364 banks, AFLAC's average operating cost per policy is more than 35% below that of its nearest competitor.

As previously mentioned, the shares of AFLAC have been under considerable pressure this year as a result of investor concerns related to: 1) the Tohoku earthquake and ensuing tsunami that hit Japan in March, and 2) the short-term ramifications related to the company's decision to de-risk its investment portfolio. However, we firmly believe that the tragic events of March 11, 2011 will not have a material impact on the overall long-term return profile of the business. The areas affected by the earthquake/tsunami were concentrated in 3 of Japan's 47 prefectures, which only represent less than 3% of AFLAC's policies in force. In addition, the company's announcement in May that it will sell some of its European sovereign debt holdings does not change our investment thesis. Although these actions will put near-term pressure on returns, we believe that reducing risk is in the long-term best interests of shareholders and that said actions will not materially impact either the company's capital levels or returns over our investment time horizon. AFLAC remains flush with capital and continues to generate more than \$2 billion annually in free cash flow. In fact, AFLAC could write its entire exposure to troubled European countries down to zero and it would still remain well capitalized. As such, we continue to believe that the company's exposure to losses in its investment portfolio is very manageable. Moreover, we remain confident that AFLAC will persist in generating improving returns by continuing its successful mix shift toward higher-return supplemental health products.

**Talisman Energy** (TLM, 3.72%), which we have owned for several years, was also a negative contributor to returns during the quarter. Talisman is a Canadian-based independent oil and gas company with operations focused primarily in North America, the North Sea, and Southeast Asia. The weakness during the quarter can be largely explained by the decline in oil and gas prices, as oil and gas equities are highly correlated with changes in commodity prices over short periods of time.

Over longer periods of time, however, we believe that share prices are driven less by changes in commodity prices and more by changes in net asset value and company-specific value creation.

Importantly, Talisman's management team has been restructuring the company's assets over the last several years. Since John Manzoni took over as CEO, the company has divested higher-cost properties in Canada and redeployed capital into lower-cost, higher-return projects in North America and Southeast Asia. Within North America, the company has reallocated capital to the Marcellus Shale, Eagleford Shale and Montney Shale projects – areas expected to generate attractive rates of return across the commodity price cycle. The results thus far have been promising owing to a combination of significant declines in finding and development costs, an increase in incremental returns on capital, and an improvement in net asset value growth. While this transition is still ongoing, the significant strides made over the last few years lead us to believe that further improvements in returns on invested capital and net asset value growth are likely to occur, independent of what happens to the underlying commodity prices.

**Sector Allocation<sup>2</sup>**  
(As of 6/30/11)

|                        |        |
|------------------------|--------|
| Financial Services     | 23.12% |
| Consumer Discretionary | 17.65% |
| Materials & Processing | 14.74% |
| Energy                 | 14.25% |
| Technology             | 10.89% |
| Health Care            | 5.51%  |
| Producer Durables      | 3.67%  |
| Utilities              | 3.24%  |
| Consumer Staples       | 0.00%  |
| Cash                   | 6.93%  |

**Top Ten Holdings<sup>3</sup>**  
(As of 6/30/11)

|                            |       |
|----------------------------|-------|
| Praxair, Inc.              | 4.39% |
| Atmel Corp.                | 4.34% |
| Warner Chilcott PLC        | 3.74% |
| Talisman Energy, Inc.      | 3.72% |
| Aflac, Inc.                | 3.63% |
| eBay, Inc.                 | 3.57% |
| FMC Corp.                  | 3.46% |
| Symantec Corp.             | 3.43% |
| Ameriprise Financial, Inc. | 3.33% |
| Southwestern Energy Co.    | 3.33% |

## Performance

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

|  | Second<br>Quarter<br>2011 | 1-Year | 3-Year | 5-Year | 10-Year | Since<br>Inception <sup>4</sup> |
|--|---------------------------|--------|--------|--------|---------|---------------------------------|
| RS Value Fund, Class A                               |                           |        |        |        |         |                                 |
| without sales charge                                 | -2.29%                    | 27.85% | 1.76%  | 3.58%  | 10.36%  | 6.99%                           |
| with maximum sales charge                            | -6.94%                    | 21.77% | 0.12%  | 2.58%  | 9.83%   | 6.70%                           |
| Russell Midcap <sup>®</sup> Value Index <sup>1</sup> | -0.69%                    | 34.28% | 6.35%  | 4.01%  | 8.42%   | 10.89%                          |

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

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 1.41%. 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).

<sup>1</sup> The Russell Midcap<sup>®</sup> Value Index is an unmanaged market-capitalization-weighted index that measures the performance of those companies in the Russell Midcap Index with lower price-to-book ratios and lower forecasted growth values. (The Russell Midcap<sup>®</sup> Index measures the performance of the 800 smallest companies in the Russell 1000<sup>®</sup> Index, which consists of the 1,000 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, the index does not incur fees or expenses.

<sup>2</sup> 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.

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

<sup>4</sup> Class A shares inception date June 30, 1993.

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|                  |                                |                      |   |
|------------------|--------------------------------|----------------------|---|
| Not a<br>Deposit | Not FDIC<br>or NCUA<br>Insured | May<br>Lose<br>Value | No Bank or<br>Credit Union<br>Guarantee |
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