RS|investments

Fourth Quarter 2011 Mutual Fund Commentary
RS Partners Fund

Philosophy and Process

We believe that company-specific value creation is often mispriced in the public markets. As such, the RS Value Group employs an investment process that is private equity-like in nature, both in-terms of the business-specific research that we conduct and the returns that we attempt to exploit. We are interested in understanding how companies create value over time, which by definition means 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 these capital decisions. When we have identified situations where there is a clear path towards future value creation, and a management team is in place that we believe is capable of executing the business plan, a company qualifies for our “farm team”. However, as value investors, we know that risk is not defined as share price volatility, but rather the permanent impairment of capital. As a result, farm team names only come into the portfolio when we can: a) clearly quantify a downside or safety net value, and b) the market provides us with an opportunity to purchase an interest in the company close to or, preferably, below that safety net. We acknowledge that over short periods of time we may underperform a benchmark, but believe that our team structure, philosophy and process will continue to provide us with the opportunity to generate superior risk-adjusted returns over a reasonable investment horizon.

2011 in Review

2011 was a challenging year for active managers, and we were no exception. In our assessment, our underperformance primarily can be attributed to the fact that we tend to run fairly concentrated portfolios where the structural change that is driving company specific value creation often takes time to unfold. An increasingly myopic market has shown little patience, and this has manifested itself in poor performance among some very good businesses that are in the midst of significant structural change.

As long-time readers know, continuous improvement is a central aspect of our team’s culture and compensation system. As a result we always place a significant emphasis on finding ways to continue to get better as investment professionals. One area to highlight is our persistent efforts to broaden our farm team. In the same way that we ask our portfolio companies to rank order their investment opportunities, we want to continually increase the competition for capital across an array of businesses. We have added two team members to our investment staff during the year, and we expect that the tension between more rocks being turned over and a commitment to running a concentrated, high conviction strategy will improve our ability to generate superior risk-adjusted returns across a full economic cycle.

Clearly, 2011 was difficult yet, as we look at our team and our portfolio, we are encouraged. Our portfolio companies generally continue to strengthen their competitive positions, invest capital wisely and execute against their business plans. In addition, we remain committed to and confident in our core philosophy and are using the current market environment to selectively deploy capital. The Fund performed well in both 2009 and 2010, largely as the result of decisions made in the depths of the 2007-2008 financial crises. Similarly, we have a high degree of conviction that the decisions that we are making today - concentrating capital in our most differentiated ideas and continually turning over more rocks to increase the competition for capital - will ultimately be rewarded.

Returns and Attribution Detail

For the fourth quarter of 2011, RS Partners Fund (Class A Shares) generated a return of 12.38% versus 15.97% for the benchmark Russell 2000® Value Index[1]. Energy and Utilities were the Fund's two best relative performing sectors during the fourth quarter, led by oil & gas producers Denbury Resources (2.82% position as of 12/31/11) and Concho Resources (2.54%) as well as Questar Corp. (2.79%) and Calpine Corp. (3.90%) within Utilities. Materials & Processing and Producer Durables were relative underperformers during the quarter. Within Materials & Processing, New Gold (a gold mining company, 3.02%) and Compass Minerals (a producer of salt and potash, 3.79%) underperformed, while Waste Connections (a waste collection and disposal company operating in secondary markets of the western United States, 3.04%) underperformed in Producer Durables.

For the full year 2011, the Fund –declined 7.59% versus a 5.50% decline for the benchmark. Producer Durables and Consumer Discretionary were the Fund's two best relative performing sectors during 2011, led by Waste Connections as well as specialty retailer Gamestop Corp. (4.70%), respectively. Conversely, Financial Services and Technology were the two sectors that most negatively impacted the Fund's relative performance for the full-year period. Within Financials, MF Global Holdings (sold from the Fund in 2011), private mortgage insurance provider MGIC Investment (also sold from the Fund) and regional bank First Horizon National Corp. (2.98%) were the biggest laggards. Within Technology, Atmel Corp. (a designer of semiconductor integrated circuit products and capacitive touch solutions, 2.68%) underperformed during the year.

Portfolio Positioning

Financials

During late 2009 and early 2010, we became more constructive on financial services businesses which, in turn, led to the Fund's increased exposure to the sector. During this period we deployed capital into businesses that were well capitalized, had limited liquidity risk, strong management teams, improving returns on invested capital, and a favorable risk/reward profile. In our initial analysis, we considered our investments in light of the recent credit crisis and identified potential risks to include increased regulatory scrutiny, further pressure on already historically low interest rates, as well as the impact of a highly fragile global economy. While fundamentals (e.g., credit and capital adequacy) on many of our financial businesses have held up reasonably well, several investments were overwhelmed by the negative impacts of increased regulatory scrutiny and the government's stated objective to keep interest rates at historically low levels for the foreseeable future.

As mentioned in previous quarterly letters, within banks, we focus on relationship lenders with strong core deposit franchises. With capital and liquidity issues more than adequately addressed, we

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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. Performance results assume the reinvestment of dividends and capital gains.

believe that well-capitalized, low cost core deposit franchises are best positioned to generate improving risk-adjusted returns within the industry. While many of our investments in banks maintain strong deposit franchises, are well capitalized and have largely put the majority of their credit losses behind them, performance results have been challenged. This has been largely due to continued uncertainty around future capital level requirements, a persistent drop in interest rates and a flattening of the overall yield curve. Given that banks are in the business of borrowing short and lending long, the flattening yield curve has placed meaningful pressure on both spreads and returns.

Within the insurance space, we continue to focus on businesses with advantaged distribution models and niche product offerings that provide a significant competitive advantage. Our approach to creating shareholder value in the insurance space is to focus on companies with a strong market presence in specialty lines of business that can leverage a structurally advantaged distribution model. We continue to believe that these business models will generate superior risk-adjusted returns over our longer-term investment time horizon.

Turning to the current marketplace, we continually monitor and reassess any changes to both the controllable and uncontrollable risks and opportunities within financials, and look for instances where headwinds for some businesses might create tailwinds for others. For example, one positive effect of the low interest rate environment has been a change in pricing for the Property and Casualty insurers, after seven years of price declines. A significant portion of an insurance underwriter's cash flows are generated by its investments in low-leveraged, high-quality fixed income assets. Given a flattening yield curve and negative cash flows for many players in the industry, we believe that the Property & Casualty insurance industry is in the early innings of a multi-year pricing increase. As always, 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

While we remain cautious regarding the health of the consumer, we have encountered recent data that supports a view that U.S. consumers are resiliently fighting their way through difficult employment and residential housing markets. As such, although we believe it is prudent to remain cautious about underlying demand fundamentals, we believe the market continues to provide us with compelling opportunities to allocate capital to select mispriced businesses. As the market overly discounts certain macro- and company-specific concerns, we believe that attractive opportunities will emerge to add to existing positions as well as initiate select new 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.

Misunderstood businesses or asset values are a function of many variables. In the Consumer, Business Services, Technology and Healthcare sectors our team searches for companies that are mispriced, yet provide reliable, understandable and predictable cashflows. For various reasons, we believe the market has a tendency to extrapolate short term results, data and opinions, offering longer-term investors with the chance to purchase stakes in certain businesses at opportunistic prices. We focus our time and resources on studying and understanding the various products, services, segments and geographies of potential investment opportunities in order to prepare for the time when the market affords us with an attractive entrance price.

In the case of healthcare, we continue to find contrarian opportunities resulting from the ever changing perceptions and realities associated with President Obama's healthcare initiatives. As the impact of healthcare reform becomes clarified, we believe winners and losers will emerge. As such, we have found opportunities to allocate capital to companies that we believe should thrive over the next several years. 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.

Hard Assets

We split our universe between "Industrials" and “Natural Resource” businesses. The primary difference between the two groups relates to the laws of mean reversion of returns. 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

As we have stated in past commentaries, we remain concerned about most industrial 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 relative to our downside calculation, and estimate equity returns based on company specific initiatives, we deploy our clients’ capital.

In addition, we have believed for some time that the US manufacturing base may be in the early stages of a renaissance, driven by a relative improvement in its competitive position as the result of limited wage pressure, spare capacity, an increasingly world class energy resource in the form of natural gas and, until more recently, a weak currency.

Natural Resources

Our objective in managing investments within natural resources is to optimize risk-adjusted returns across a full commodity price cycle. 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.

Commodity prices and natural resource equities were mixed during 2011, with meaningful disconnects between the performance of the commodities and that of the related equities. For instance, while oil prices increased during the year due to tight inventories and rising concern around geopolitical tensions, many oil stocks declined. The story in gold was similar, with bullion posting another positive year but many gold stocks down. In natural gas, the opposite was true, as the commodity continues to be under pressure from excess supply, stocks benefited from large scale acquisitions and joint ventures, as well as improving economics in areas such as the Marcellus shale.

Going forward, the demand backdrop is mixed, as the challenges of working through pools of leverage both domestically and abroad are off-set by nascent signs of improvement in the US and the expectations that China will continue to effectively manage its economic cycles. Fortunately or otherwise, that is about as far as we go in-terms of the macro. We have, and always will, rely on what we can quantify and understand in a simple, durable framework. For us, that is assessing the dynamics of the supply side of the equation. We remain confident in our belief that the longer-term outlook for commodities is intact, driven primarily by limited spare capacity and rising marginal costs of supply. Thus, while commodity prices may continue to be volatile, we believe that these short-term price movements provide patient, long-term investors with opportunities to deploy capital at very attractive prices relative to asset values. Despite the increased nearer-term uncertainty, we believe that the longer-term outlook for returns has become more attractive given the recent weakness in commodity prices and the even greater decline in natural resource equities.

At the end of the year, we estimated that natural resource equities traded on average at a 0-5% discount to net asset value, with significant differences across the commodity complex. Over the course of 2011, natural resource equities traded as high as 15-20% above and as low as 15-20% below net asset value, a range that is in line with historical norms. Markets such as these, characterized by volatility and frequent discrepancies between asset value and stock prices, are attractive environments to deploy capital, particularly given the favorable outlook for growth in net asset value at the company level. 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.

Team Update

In much the same way that we ask our companies to manage our clients' capital, we are constantly in search of high return investment opportunities that we believe will have a meaningful impact on our process and our team. As mentioned in our previous commentary, we are pleased to announce that during 2011 we further strengthened our team with two terrific new hires:

Paul Hamilos joins our Financials Team after serving as a Vice President of the Principal Transaction Group at Macquarie Group, where he focused on the specialty finance industry. Previously, he was an Associate at American Capital Strategies focusing on mezzanine debt financing within the financial sponsors group. Paul holds a B.S in business administration, with a concentration in finance and banking, from the University of Missouri and an M.B.A from The University of Chicago Booth School of Business. Paul is a CFA Charterholder.

Andy Walker joins our Hard Assets Team after serving as a research analyst at Janus Capital Group for twelve years, covering the power and industrial sectors. Previously, he was a financial analyst in the corporate finance and investment banking divisions of Goldman, Sachs & Co. Andy holds a B.A. in economics and history from Yale University and an M.B.A. from Harvard Business School. Andy is also a CFA Charterholder. Andy's background in power and mid-stream assets will reinforce our ability to conduct thorough, project-by-project research across the full spectrum of commodities.

Various members of the RS Value Team have known both Paul and Andy for many years so we have no doubts that they meet our "character over credentials" requirement, although their credentials aren't bad, either. These personnel additions were made to strengthen our team so that we can further increase our knowledge and understanding of our portfolio companies. We are firm believers that, in the final analysis, knowledge is the best risk mitigant. Moreover, our business

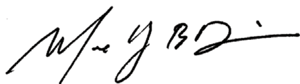
model requires that each investment professional be responsible for just one new investment idea every three to four months. As such, we are able to encourage team members to be extraordinarily thorough in their due diligence and give them the time and resources to become the most knowledgeable investors in the market. With the addition of Paul and Andy, our team today is as deep and as strong as it has ever been.

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. Our team today is as deep and as strong as it has ever been and we are able to encourage our team members to be extraordinarily thorough in their due diligence in order to become the most knowledgeable investors in the market. Moreover, we think that the Fund is very well positioned for an environment where individual company-specific cash flow fundamentals are properly rewarded.

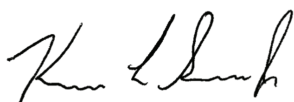
We are, as always, thankful for your patience and support.

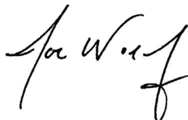
Sincerely,


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. 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. 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.

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 December 31, 2011.

RS Funds are sold by prospectus only. You should carefully consider the investment objectives, risks, charges and expenses of the RS Funds before making an investment decision. The prospectus contains this and other important information. Please read it carefully before investing or sending money. To obtain a copy, please call 800-766-3863 or visit www.RSinvestments.com.

Appendix – Stock Examples

Aimia's (AIM CN, 3.87% position as of 12/31/2011**)** primary business is the management of coalition loyalty programs in Canada and Europe, under the brand names Aeroplan (in Canada) and Nectar (in the UK and Italy). The company, which was formerly known as Groupe Aeroplan, was created in 1984 by Air Canada as an internal frequent flyer program. In 2002 the business was spun out from Air Canada and the company began expanding its frequent flyer program to transform it into a broader coalition program. In 2007, the company expanded beyond the Canadian market through its acquisition of Loyalty Management Group, which owned the Nectar UK loyalty program.

Aeroplan Miles (or Nectar Points) are essentially a currency created and managed by Aimia. These Miles are earned and accumulated by members of Aimia's loyalty coalitions and redeemed for valuable goods and services, most notably air travel. They are a unique reward that is valued by coalition members and thus serve as an effective marketing/loyalty tool by credit card companies, airlines, grocers, gas stations, etc. (referred to as "Accumulation Partners").

Aimia sells Miles to its Accumulation Partners at an average price of 1.25 cents per Mile. Program members, in turn, earn Miles as they spend money with the Accumulation Partners. Once they have accumulated enough Miles, members can redeem their Miles with any of Aimia's Redemption Partners (e.g., Air Canada), at which point Aimia pays the Redemption Partners for the cost of the services provided (this cost averages ~0.90 cents per Mile). The beauty of the business model is that Aimia earns a gross profit on the spread between the price it charges per Mile and the cost of the Miles redeemed, while also earning a 100% margin on the 18%-20% of Miles that are never redeemed (referred to as "breakage"). In addition, the business has extremely attractive cash flow characteristics as it collects its cash up front when Miles are sold but does not pay out cash until Miles are redeemed (an average lag of approximately 30 months).

Aimia has a strong competitive position because of its contractual relationship with Air Canada (the dominant airline in Canada, with approximately 60% market share), pursuant to which 8% of Air Canada's seat inventory is made available to Aeroplan members at very attractive redemption rates. This makes the Aeroplan Miles very valuable to Aeroplan Members, which in turn makes the Aeroplan Program an efficient loyalty tool for the Accumulation Partners. This network effect allows for a very profitable, high-return business model with significant barriers to entry.

We believe that Aimia trades at a substantial discount to its warranted value given the complexity of its accounting, its short history as a public company and the lack of a representative peer group. Furthermore, we think that Aimia's warranted value will increase over time as its return on capital continues to improve. There is almost no additional capital required to grow the business so incremental returns on organic growth are nearly infinite. In fact, due to the negative working capital dynamics, Aimia actually gets paid to grow. Furthermore, Aimia has numerous opportunities to reinvest as it re-creates its coalition loyalty programs in new geographies. For example, Aimia has successfully expanded the Nectar program into Italy and has invested in Club Premier, the frequent flyer program of AeroMexico. Potential markets in the future include India, Latin America, and the United States. We believe the valuation of this business, at less than 10X free cash flow (and includes a 5% dividend yield), is very attractive given Aimia's compelling reinvestment opportunities and continued improving return profile.

Headquartered in McKinney, TX, **Torchmark Corporation (TMK**, 3.31%**)** is a provider of life and supplemental health insurance to middle income Americans. The company, led by CEO Mark McAndrew, offers its products through its more than 6,000 captive agents as well as through direct offers via mail, Internet, and Television. The company's life insurance products (which represent approximately 75% of cash flows) are focused on fixed benefit, low premium term and whole life products, providing Torchmark with steady cash flows that are not materially impacted by capital markets activity. The Health segment focuses on defined benefit accident and supplemental health insurance and features similar cash flow characteristics.

Through Torchmark's captive and direct distribution model, the company operates at a significant cost advantage to the independent agency-driven model utilized by most competitors, which is focused on price and ratings. Torchmark's captive agents primarily sell Torchmark-only products and operate as independent contractors, which minimizes overhead costs. In the direct channel, cost to acquire is roughly half that of the independent agency channel. In total, through its advantaged distribution model, Torchmark's return profile is over 400 bps higher than its competitors. Moreover, the combination of high persistency of 90+% and low volatility in losses (because of a lack of capital markets exposure) provide Torchmark with very consistent and predictable cash flow generation.

We entered into our position in Torchmark during the depths of the financial crisis, as concerns surrounding investment portfolios, reserving for capital markets sensitive life products and ratings agency downgrades were at the forefront of investors' minds. Because of Torchmark's captive/direct distribution model, we felt that any negative actions against the company by the rating agencies wouldn't impact Torchmark's business the same way it might those companies that depend more on a ratings-focused, independent agency channel. Moreover, because Torchmark operates at lower investment leverage (2.8X) and invests almost entirely in investment grade corporates, we believed that the risk of material permanent capital impairment was very low. This turned out to be accurate, as Torchmark suffered losses of only 1.23% of invested assets at the peak, representing less than 2 quarters of cash flow. The lack of exposure to equity and fixed income markets in many of Torchmark's products (e.g., variable annuities and variable life), meant that cash flows were only minimally impacted by the dislocations occurring during this difficult period.

Torchmark has proven to be a highly resilient, cash flow generating business even against a very challenging investment and operating backdrop. We continue to like the business given the recurring nature of its cash flows and the fact that it is a very well run business, headed by CEO Mark McAndrew, who has proven to be a good steward of capital. Moreover, we feel that valuation remains compelling and that our downside remains well protected owing to the fact that the company continues to trade very close to its tangible book value.

Sector Allocation[2]
(As of 12/31/11)

Sector	%
Financial Services	22.22%
Technology	16.69%
Consumer Discretionary	14.27%
Health Care	9.59%
Energy	9.40%
Materials & Processing	6.82%
Utilities	6.71%
Producer Durables	3.05%
Consumer Staples	0.00%
Cash	11.26%

Top Ten Holdings[3]
(As of 12/31/11)

Holding	%
GameStop Corp.	4.70%
Calpine Corp.	3.90%
Groupe Aeroplan, Inc.	3.87%
Compass Minerals International, Inc.	3.79%
AOL, Inc.	3.70%
Acxiom Corp.	3.39%
Torchmark Corp.	3.31%
Peyto Exploration & Development Corp.	3.27%
StanCorp Financial Group, Inc.	3.13%
Myriad Genetics, Inc.	3.10%

Performance
(Average Annual Total Returns as of 12/31/11)

	Fourth Quarter 2011	1-Year	3-Year	5-Year	10-Year	Since Inception[4]
RS Partners Fund, Class A						
without sales charge	12.38%	-7.59%	19.33%	0.06%	10.69%	11.03%
with maximum sales charge	7.03%	-11.98%	17.41%	-0.91%	10.15%	10.70%
Russell 2000® Value Index[1]	15.97%	-5.50%	12.36%	-1.87%	6.40%	9.04%

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

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1 The Russell 2000® Value Index is an unmanaged market-capitalization-weighted index that measures the performance of those companies in the Russell 2000® Index with lower price-to-book ratios and lower forecasted growth values. (The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000® 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.
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 July 12, 1995.

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