

Fourth Quarter 2009 Mutual Fund Commentary RS Strategic Income Fund

Fund Introduction and Philosophy

The RS Strategic Income Fund provides actively managed exposure to multiple fixed income sectors including investment grade and high yield, U.S. and foreign securities. The fund draws on the vast experience and expertise of a six-member team of co-portfolio managers, each of whom manages these asset classes for institutional accounts or other RS Funds. The fund follows the same overall process and philosophy used by the team that manages all of the RS fixed income funds. The fund received \$50 million of seed capital ahead of year end 2009 from The Guardian Life Insurance Company of America (Guardian Life) and was able to position a diversified portfolio of holdings as of 12/31/09.

The fund objectives are to seek a high current income, with capital appreciation as a secondary objective. Our investment approach is fundamental value focused, meaning we evaluate the fundamental merits of each bond ourselves and also compare the potential returns to the downside risks. In other words, we seek to add value relative to risk, considering the risks of an investment, rather than focusing only on yield (focusing only on yield can lead to consistently high levels of credit risk in a portfolio since higher risk bonds usually offer higher yields).

In making allocations, the fund considers all investment grade categories, as well as an allocation to high yield holdings and an allocation to a global strategy (non-US dollar (USD) denominated bonds, which may be hedged or unhedged).

Outlook

We expect slow underlying growth, with some areas of the economy still struggling, and the need for policy unwinds. Taking that into account, as you will read in the Portfolio Positioning section, a number of fixed income sectors look attractive.

We expect headline Gross Domestic Product (GDP) growth to look quite strong for a few quarters, but then fade back below 3% as the big boost from slower inventory liquidations fades. (Due to the quirks of GDP accounting, if inventories just stop contracting, that could add over 2 points on average to 4Q09 and 1Q10 growth). Aside from the inventory boost, we think key underlying drivers of growth will be slow, particularly consumption: consumers balance sheets have not improved much, income growth is likely to remain slow, and credit availability is constrained (write-offs plus regulatory and accounting changes that will drive banks to need to hold more capital overall, and which are leading them to cut back some types of consumer lending in particular, such as credit cards). Small business still face restricted credit, and large policy uncertainties can make them reluctant to hire as quickly coming out of this recession. While we expect residential investment to continue to move up from historically low levels and be an addition to GDP growth, we see many ongoing challenges for the housing markets that will prevent it from being a big engine for growth and present some risks as well: we expect additional foreclosures, prime delinquencies are still rising, more than a quarter of mortgages are already underwater (meaning the home values are less than mortgage balance), large inventory of existing homes for sale, and we expect some further home price depreciation (about 8%). Commercial real estate also faces challenges given higher delinquencies (4.7% as of November), lower rents, lower property values, and lack of financing alternatives.

Economic weakness and deleveraging in the last two years was cushioned by expansionary fiscal and monetary policy. The (eventual) quest to get back to neutral on those policies will be a headwind over the next few years. Policy uncertainties (healthcare, cap and trade, financial regulations) and deficits both present major hurdles for the economy and will likely lead to higher tax rates to fund new spending initiatives and in an attempt to close government deficits.

We expect core inflation to be fairly stable, but with a risk of rising inflation expectations focused mainly around the risk of policy mistakes, such as not addressing deficits or allowing loose monetary policy to go on for too long.

During 2010, we expect the Federal Reserve Board (the Fed) to begin raising rates and trying to unwind some of its extraordinary balance sheet expansion. The Fed's balance sheet reached \$2.2 Trillion by late 2009, up from about \$800 billion before the crisis. It will grow further in the first half of 2010, despite the end of some programs and roll off of some short term assets, as the Fed finishes previously announced programs such as purchasing Mortgage Backed Securities (MBS). After that, we expect them to achieve some shrinkage, and further mitigate the impact of the large balance sheet with other tools such as reverse repos and the recently proposed term deposits. The near-zero target fed funds rate is too loose for the long term. The Fed may try to delay hiking this until the second half of the year given the bias to protect against economic downside risks, but they will inevitably need to take back some of the excess accommodation, and will act more quickly if inflation expectations do rise and if it cannot effectively shrink its balance sheet in a timely way.

Portfolio Positioning

We see value in quite a few sectors of the fixed income markets at the moment. Our outlook and assessment of valuations lead us to allocate larger portions of the fund to some sectors over others, with some of the highest allocations to investment grade corporates, global bonds, and high yield corporates. We assess that the slow underlying economic growth we expect is "good enough" for both investment grade corporates and BB and single B high yield. With the economy growing, we expect earnings to improve as companies that have cut costs can translate higher revenues into improved earnings, and companies that have controlled debt levels will have improving credits as leverage (the amount of debt relative to earnings can fall as earnings rise) declines. Given this view and attractive yield premiums relative to the fundamentals, as of year end we had allocated a large portion (around half) of the portfolio to corporate credit, weighted more heavily towards investment grade, with about 15% of the overall portfolio in high yield corporates.

On the other hand, we feel that slow growth is "not good enough" to cure all that ails the real estate markets given the challenges noted in the Outlook section. Despite not liking the fundamentals for the broader sector, there are a number of individual securities we like in the residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS) sectors, but selection of these requires very rigorous analysis of the loans characteristics and performance as well as the deal structures. Given year end valuations in non-agency RMBS and CMBS, we intended to focus on more senior bonds with good enhancement relative to credit metrics.

We purchased some municipals for this portfolio prior to year end in select credits we felt were cheap given yields above Treasuries. Further, our expectation is that taxes are likely to rise, which would help push municipal valuations higher relative to Treasuries.

We positioned over 15% of the portfolio in non USD denominated debt as of year end, in countries where we felt there was better return potential than in the US for similar maturity instruments.

We look forward to adjusting allocations as opportunities change in the market place.

Sincerely,



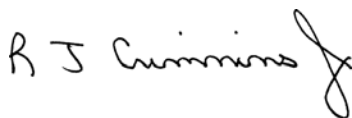
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As with all mutual funds, the value of an investment in the Fund could decline, so you could lose money. Bond funds are subject to interest rate risk, credit risk and prepayment risk. When interest rates rise, bond prices generally fall, and when interest rates fall, bond prices generally rise. Currently, interest rates are at relatively low levels. Please keep in mind that in this kind of environment, the risk that bond prices may fall when interest rates rise is potentially greater. The values of mortgage-backed securities depend on the credit quality and adequacy of the underlying assets or collateral and may be highly volatile. Derivative transactions can create leverage and may be highly volatile. It is possible that a derivative transaction will result in a loss greater than the principal amount invested and the Fund may not be able to close out a derivative transaction at a favorable time or price.

High Yield bond investing includes special risks. Investments in lower rated and unrated debt securities are subject to greater loss of principal and interest than investments in higher rated securities.

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 December 31, 2009.

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

¹ Barclays Capital High Yield Municipal Bond index returns only available since 5/22/2003.

² Credit ratings are issued by credit rating agencies and reflect the agency's assessment of the risk of a bond based on the issuer's capacity to meet its financial commitment on the bond.

³ Barclays Capital Municipal Bond Index is an unmanaged index that is a broad measure of performance of investment-grade municipal bonds with maturities of at least one year. It is not possible to invest directly in an Index.

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