



Fourth Quarter 2011 Mutual Fund Commentary RS Tax-Exempt Fund

Performance

(Average Annual Total Returns as of 12/31/2011)

RS Tax-Exempt Fund (Class A – GUTEX)

	Fourth Quarter 2011	1-Year	3-Year	5-Year	10-Year	Since Inception (2/16/93)
without sales charge	2.38%	11.11%	7.84%	4.89%	5.33%	5.12%
with maximum sales charge	-1.46%	6.92%	6.47%	4.10%	4.93%	4.90%
Barclays Capital Municipal Bond Index ¹	2.12%	10.70%	8.57%	5.22%	5.38%	5.76%

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

Fund Highlights

Portfolio Overweights

- AAA and Baa credits

Portfolio Underweights

- Healthcare
- AA and A credits

Outlook

- Nominal yields and supply could impact performance

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 performance quoted, “with maximum sales charge” reflects the current maximum sales charge of 3.75%. The Fund’s total gross/net annual operating expense ratio as of the most current prospectus for the Class A Shares is 0.96%/0.80%. Current performance may be lower or higher than performance data quoted. Performance current to the most recent month-end is available by contacting RS Investments at 800-766-3863 and is frequently updated on our Web site: www.RSinvestments.com.

The Fund is the successor to The Guardian Tax-Exempt Fund; performance shown includes performance of the predecessor fund for periods prior to October 9, 2006. The net expense ratio quoted above reflects a contractual expense limitation which will continue through 4/30/11. The views expressed in the portfolio manager commentaries are those of the Fund’s portfolio manager(s) and are subject to change without notice. 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. Certain share classes are subject to lower maximum sales charges whether paid at the time of purchase or deferred. A “deferred sales charge” also known as “back end load” or “CDSC” is incurred when liquidating an A share purchase over \$1 million, for example, before a specified holding period. Any sales charges are in addition to the Fund’s fees and expenses as detailed in the Fund’s most current prospectus. Fees and expenses are factored into the net asset value of your shares and any performance numbers we release.

Fund Commentary

Performance

RS Tax-Exempt Fund (Class A shares) (the “Fund”), had a total rate of return of 2.38% for the quarter ended December 31, 2011, versus its benchmark, the Barclays Capital Municipal Bond Index, which returned 2.12%¹. For the twelve months ended December 31, 2011, the Fund had a total return of 11.11%, versus the Barclays benchmark return of 10.70%. We would note that, unlike the Fund, the benchmark return does not include expenses. In addition, at any one time, the benchmark has approximately 46,025 issues,² whereas the Fund generally has exposure to only about 180 to 220 carefully selected issues³, some of which may not be in the benchmark.

We believe that peer group comparisons from Lipper provide a more meaningful comparison. Funds in the Lipper General Municipal Debt Fund^{1,4} category invest primarily in municipal debt issues in the top four credit ratings. Lipper rankings are based on total return with dividends reinvested and do not take into account or reflect sales charges. As shown in the chart below, the Fund had favorable performance compared with the Lipper peer group for the five- and ten-year periods ended December 31, 2011.

For the ten years ended December 31, 2011, Lipper ranked the Fund 12th out of 161 funds and was in the first quartile of its Lipper peer group.⁴ Over the long term the Fund has ascended to the ranks of one of the best performing national tax-exempt funds as determined by Lipper.⁴ During the fourth quarter, the RS Tax-Exempt Fund maintained an overall high-grade credit profile and held no bonds that were not rated by a rating agency or with a below investment grade rating.

(As of 12/31/2011)⁴	1-Year	3-Year	5-Year	10-Year
RS Tax-Exempt Fund (Class A) Average Annual Total Return	11.11%	7.84%	4.89%	5.33%
Lipper General Municipal Debt Funds Average Annual Total Return	10.56%	9.54%	3.71%	4.36%
Lipper General Municipal Debt Funds Category Ranking*	66/245	175/222	30/193	12/161
Lipper General Municipal Debt Funds Category Percentile	27%	79%	16%	8%

*Lipper rankings are based on total return with dividends reinvested and do not take into account or reflect sales charges.

As of December 31, 2011, the Fund’s 30-day SEC yield was 2.45% (which grosses up to 3.77% taxable equivalent yield for a person in the highest federal income tax bracket in 2011). Without the subsidy, the Fund’s 30-day SEC yield was 2.35% (grossing up to 3.62% taxable equivalent yield for a person in the 35% income tax bracket in 2011).⁵

Portfolio Review

In the fourth quarter, only \$99.99 billion in municipals were issued versus \$133.85 billion in the fourth quarter of 2010, a 25% decline. For the full year, new issuance was \$294.94 billion versus \$433.27 billion, a 32% decline year over year. It should be noted that in 2010, \$117.35 billion in taxable Build America Bonds were issued versus only \$0.43 billion in 2011.⁶

As noted above, the total return of the Barclays Capital Municipal Bond Index for the fourth quarter was 2.12%. By credit rating⁷, the return of the AAA sector was 1.77%, AA was 1.99%, A was 2.39%, and BBB was 2.73%¹. In general, the outperformance of lower rated bonds (within the investment grade category) did not benefit the Fund during the quarter. In keeping with the Fund’s investment strategy, we did not reach for yield at the expense of credit quality, and maintained the Fund’s overall focus on issues in the higher credit rating categories. As of December 31, the ratings breakdown of the Fund’s holdings were 61.6% AAA or AA-rated, 17.3% A-rated, and 13.2% BBB rated. 7.9% of the Fund was held in other assets and liabilities.

As reported by the National Association of State Budget Officers, in the last four years, states closed more than \$325 billion of deficits with spending cuts and additional revenue.⁸ While some jurisdictions still face challenges, in 2011 the sky did not fall in. With a few exceptions of local government issuers, the worst did not happen. While managing the budgets was challenging, the vast majority did what needed to be done. Some of the more notable fiscal-distress candidates in local government space were one-off, isolated events and not evidence of any systemic issue.

From a trading and performance point of view, the beginning of 2011 was not shaping up as a good year for municipals. It started with the “prediction”⁹ that there would be hundreds of billions of municipal defaults which caused investors to redeem their shares from tax-exempt municipal bond funds. These redemptions drove NAVs (net asset values) lower as bond funds needed to sell bonds to satisfy these redemptions.⁹

As the “prediction” evaporated municipal buyers stepped back into the market,⁹ but not with the same force that they had left. Gradually, the municipal buyer became more confident, and by the fourth quarter of 2011 had isolated the notable bankruptcies (which are discussed below) away from the municipal market as they continued to purchase both bonds and funds. The tax-exempt municipal market ended the year as one of the best performing asset classes for 2011.

On September 16, Jefferson County, Alabama officials had announced an agreement with bondholders to restructure more than \$3 billion of its sewer revenue debt that had been in default for three years. The deal fell apart and on November 9, the county filed for bankruptcy protection under Chapter 9 of the U.S. Bankruptcy Code. The total county debt now in default is \$4.105 billion and is the largest-ever municipal bankruptcy filing. By the end of December, the filing was being challenged by certain bondholders who wanted the state-court appointed receiver of the county's sewer system to remain in control of its finances and operations as the bankruptcy proceeds.¹⁰ The Fund does not currently hold any of these bonds.

On November 16, a report by the California Legislative Analyst's Office projected billion dollar revenue shortfalls in the state's current budget.¹¹ The shortfalls triggered expenditure cuts. In December, the governor began pitching a vote for the November 2012 ballot to raise income taxes on individuals who earn \$250,000 or more and to raise sales taxes to 7.75% from 7.25%. If approved, it is estimated that the increased taxes would raise nearly \$7 billion a year.^{12,13} The Fund currently owns California state bonds.

On December 1, a Pennsylvania state judge confirmed the governor's appointment of a receiver to fix the finances of the insolvent city of Harrisburg, driven into default by a troubled incinerator project. The State had filed its takeover petition to the state court on November 18, and a recovery plan is to be submitted by February 6, 2012.¹⁴ Earlier, the City Council, over the Mayor's opposition, had tried to file under Chapter 9. Without the required state authorization, the case was thrown out by the bankruptcy judge. On December 22, it was reported that the City Council was appealing the judge's decision.¹⁵ The Fund currently does not own any of the bonds.

We seek to thoroughly understand the bonds that we purchase for the Fund; for example, we believe that our understanding of the revenue stream is essential to understanding the bond. We look for strong revenue that flows directly to the issuer. Once the bond is purchased, we continue to monitor the cash flows.

Our long-standing investment approach for the Fund is based on our analysis of the fundamentals of each issuer, rather than reliance on a rating or insurance. Given the broad opportunity set open to a national fund, we focus on what we believe to be quality issuers that offer value, and avoid large concentrations to any one issuer, insurer, industry, sector, or state. However, when we feel we are properly compensated for risk, we will seek to purchase lower-rated credits if our research indicates upside potential for the bond.

The Fund did not use derivatives to boost returns. The Fund has also stayed away from many local issues and ones that typically depend upon appropriations and have certificate of participation (COP) structures. COPs are not voter approved and usually depend on appropriations. As for General Obligation and revenue bonds, we look for those that we deem have strong underlying credit fundamentals.

Our avoidance of appropriation debt is primarily confined to the local and county levels, whereas we view state appropriation debt differently. Some characteristics that we look for when buying state appropriation bonds are: the size of the project, the need for the project, and the history of the project, to name just a few variables.

Outlook

The Securities Industry and Financial Markets Association is predicting overall municipal bond issuance in 2012 will increase over 2011. It expects long-term issuance will increase approximately 20% to \$347 billion.¹⁶ While this is highly dependent upon a number of market-affecting factors, the strong issuance forecast underscores the market's appetite for municipal bonds despite fiscal challenges at the state and local levels.

Going forward, while the fiscal situation of the states, in general, has much improved, we believe it is still a little fragile. The revenue growth the states are experiencing is on a thin foundation and susceptible to an economic slowdown. Also, despite the fact that the "Gang of Six" in Congress didn't accomplish its goals, the discussion over deficit reduction could continue into 2012 and become part of the presidential election narrative. Tax and entitlement reforms could be part of any discussions.

Given our investment approach of focusing on the quality and stability of issuers, as well as the large opportunity set that a national fund allows us, we will continue to put our experience to work.

We see both challenges and opportunities ahead, and believe there are compelling opportunities for investors in the Fund.

Thank you for your investment and continued support.

Sincerely,



Alexander M. Grant, Jr.
Portfolio Manager

Guardian Investor Services LLC, the Fund's sub-adviser

The foregoing is the opinion of the Fund's management team as of the date of this report and is subject to change without notice.

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. Investors in the Fund may be subject to alternative minimum tax (AMT) and certain other state and local taxes.

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.

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.

Sector Allocation (As of 12/31/2011)	% Fund
State General Obligation Bonds	10.4%
Local General Obligation Bonds	13.8%
Revenue Bonds	67.9%
Special Tax	7.2%
Housing	1.4%
Education	8.0%
Water and Sewer	12.1%
Transportation	17.8%
Power	5.2%
Leasing	5.1%
Resource Recovery	0.0%
Hospital / Nursing Home / Health Care	5.8%
Industrial Revenue	5.2%
Other Assets and Liabilities	7.9%

**Top Ten Holdings⁵
(As of 12/31/2011)**

(As of 12/31/2011)	Coupon Rate	Maturity Date	% Fund
Illinois St. G.O.	5.000	01/01/19	0.92%
Wayne County MI Arpt Auth. Rev	5.000	12/01/20	0.71%
Hawaii St. G.O.	5.000	12/01/31	0.69%
Metropolitan Transn. Auth. NY Rev.	5.000	11/15/24	0.68%
Orlando & Orange Cnty FLA Expressway Auth Rev Ser. C	5.000	07/01/26	0.67%
Princes Georges Cnty. MD G.O.	5.000	09/15/29	0.64%
Puerto Rico Comwlth. Govt. Dev. Bk.	5.000	12/01/14	0.63%
North TX Twy. Auth. Dallas North Twy Sys Rev Ser C	6.000	01/01/25	0.62%
Charleston Cnty. SC G.O.	5.000	11/01/22	0.62%
California St. Dept. Veterans Affairs Home Pur. Rev.	5.000	12/01/32	0.61%

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¹ The Barclays Capital Municipal Bond Index total return data is provided by Barclays Capital. The Barclays Capital Municipal Bond Index is an unmanaged index that is generally considered to be representative of the municipal bond market and is not available for direct investment. There are no expenses associated with the index, but there are expenses associated with the Fund.

² Source: Bloomberg.

³ Source: POINT report.

⁴ Lipper, Inc. is an independent mutual fund monitoring and rating service. Its database of performance information is based on historical returns, which assume the reinvestment of dividends and distributions and the deduction of all fund expenses. Lipper return figures do not reflect the deduction of any sales charges that an investor may pay when purchasing or redeeming shares of

the Fund.

⁵ SEC Yield is a standard yield calculation developed by the Securities and Exchange Commission (SEC) that allows for fairer comparisons of bond funds. It is based on the most recent 30-Day period covered by the fund's filings with the SEC. The yield figure reflects the dividends and interest earned during the period, after the deduction of the fund's expenses. This is also referred to as the "standardized yield."

⁶ Source: Bond Buyer, Jan 3, 2011 pg 19.

⁷ Rating agencies' independent ratings of individual bonds are aggregated by Barclays and market weights are reported using Standard & Poor's letter rating conventions. Rating methodology uses the middle rating of Moody's, Standard & Poor's and Fitch. When a rating from only two of the rating agencies is available the lower rating is used.

⁸ Source: Bloomberg, December 22, 2011 'Painful' Budget Cuts May Boost Munis in 2012", Brian Chappatta.

⁹ Source: Municipal Market Data, Weekly Outlook & Primary Preview, 1/17/2012.

¹⁰ Source: The Bond Buyer, December 22, 2011.

¹¹ Source: New York Times, November 17, 2011 "Sharp Decline in Revenue Is Forecast for California".

¹² Source: Bloomberg "California's Brown May Delay or Reduce \$11 Billion Water Bond", December 28, 2011.

¹³ Source: Bond Buyer, December 16, 2011.

¹⁴ Source: Bloomberg, December 22, Harrisburg Receiver Wins More Time to File Fiscal Recovery Plan.

¹⁵ Source: Bloomberg, December 22, Harrisburg Lawyer Files Second Attempt to Appeal Its Bankruptcy.

¹⁶ Source: Bond Buyer, December 22, 2011, Robert Slavin.