

Preserving Capital and Yields

In the world of fixed income investing, extensive proprietary research and a fair evaluation of the macroeconomic environment are key components of a winning formula. Howard Chin and Robert Crimmins, portfolio managers of the RS Low Duration Bond Fund, explain how the RS fixed income team takes advantage of its analytical expertise.

Could you give a brief overview of the company?

The company has four different fixed income funds within the fixed income complex – a High Yield Bond Fund, Tax-Exempt Bond Fund, the Investment Quality Bond Fund, and the Low Duration Bond Fund. Currently, RS Investments manages \$12.5 billion for institutions and individuals.

The Low Duration Bond Fund was launched in 2003.

What are the primary factors considered when investing in the bond market?

We view the economy first. Investing in bonds really requires an understanding of the macroeconomic environment and what the Fed is likely to do.

We view the economy as being fairly anemic over the next few quarters showing a weak or negative GDP growth. But with the stimulus program kicking in, the second half of 2009 will be substantially better.

Meanwhile, we think the fourth quarter will have greater uncertainty and to a large degree it will depend on how the banking industry, as

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well as the housing market, recovers. Certainly there will be a recovery but that is one of the key risks to our forecast.

In terms of the Fed, they have communicated to the market that they intend to keep the Fed funds rate very low, currently 0-25 basis points, so we think that that will carry over into 2010. We see a steeper curve in the cards.

Our view on the other segments of the fixed income markets is that while Treasury yields are on the low side, the yields on short and intermediate Non-Treasury bonds are attractive. We think that even with the performance that these sectors have had in 2009 year-to-date, we believe that still leaves them with some more room to further outperform from that level. Looking ahead, the funds will be focused in these so-called spread sectors or non-Treasury sectors.

In addition, one needs to consider the prospect for inflation. There is a huge surplus in manufacturing capacity and with unemployment probably going over 10% and staying above 9.5% through 2010, there is going to be quite a bit of labor slack still available for the next year-and-a-half. As a result, there should not be any wage pressures to drive inflation up.

Our view going forward is that we will continue to actively manage the portfolio through the sector rotation among the spread sectors, but at this point we don't necessarily see there's that much value in the Treasury sector itself.

What is your investment philosophy?

Our investment philosophy is to provide our shareholders who invest in fixed income a



HOWARD W. CHIN has been a co-portfolio manager of RS Investment Quality Bond Fund since 1998* and of RS Low Duration Bond Fund since 2003*. He has been a managing director at Guardian Life since 1997. Chin also manages part of the fixed-income assets of Guardian Life and the fixed-income assets for other GIS subsidiaries.

Prior to joining Guardian Life, he spent four years as a strategist at Goldman Sachs & Company, and earned a B.S. in engineering from Polytechnic Institute of New York and an M.B.A. from the University of California at Berkeley.

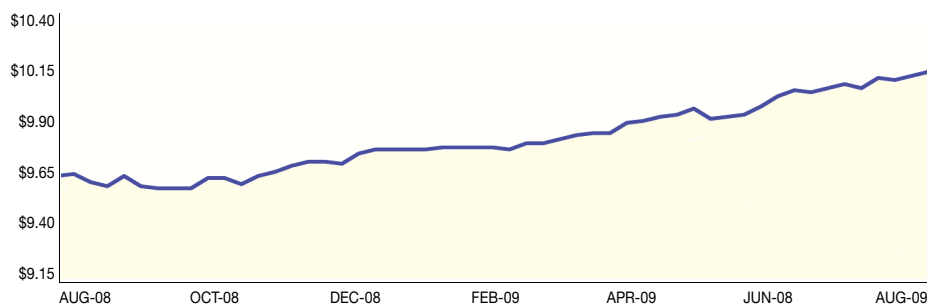


ROBERT J. CRIMMINS, JR. has been a co-portfolio manager of RS Investment Quality Bond Fund and of RS Low Duration Bond Fund since 2004*. He has been a managing director of Guardian Life since 2004. From 2001 to 2004, Crimmins was a senior director at Guardian Life and prior to that, he was an assistant vice president of fixed-income investments of Guardian Life.

Crimmins holds a B.A. in finance from St. John's University and an M.B.A. from Fordham University.

Performance - Price History N.A.V.

RS Low Duration Bond Fund (RLDAX)



stable product in terms of returns, volatility and risk.

Could you describe your investment strategy?

Our bond investment process applies a top-down and bottom-up approach. We first gain a good understanding of the economic environment as the top-down component and then we do a deep dive into each of the individual bond issues on a fundamental basis as part of the bottoms-up approach.

Do you make year-over-year comparisons of the macroeconomic environment?

We are perhaps a touch more negative than we were before. The big question is whether the various government programs will succeed in reviving the economy, above and beyond the stimulus package. That is the new element in the secular environment.

In our opinion, the results have been somewhat mixed by far. We think that certainly the Fed's mortgage-backed securities purchase program has been relatively successful in driving down mortgage rates, but that only lasted for a couple of months and now mortgage rates are about 50 basis points higher than they had been. Unfortunately, that means the relief was only temporary.

Now it is a matter of what the government is capable of doing to resume that. We are not sure if there is enough money to go and buy as many mortgages as they need to in order to drive rates back down to where they were in April and May. That's really the uncertainty because we believe that the

housing market will be a big determinant of how quickly the economy will recover.

And it is also not just a pure employment issue. We are seeing savings rates increase quite substantially now with people getting concerned about their jobs and looming layoffs. That's countercyclical, so it looks like even though the majority of the stimulus program has not been spent yet, the initial results seem to be a little bit weaker than we had hoped.

Would you tell us about your research process?

Our research process starts with the quarterly secular review or macroeconomic review. We basically get all the portfolio managers and analysts, both structured product and credit analysts as well as the traders, in a large conference room for two to four days every quarter and everybody makes the case for their view on the economy (and their sector) before we arrive at a consensus. We also spend a substantial amount of time trying to identify those areas where our opinions or our outlook might be a little bit different than consensus. Additionally, we try to quantify the risk associated with what happens if the market is right and we are wrong, and then we position the portfolio appropriately depending on the likelihood of that scenario.

We ensure that we get feedback on a regular basis. Apart from the quarterly meetings, we have weekly strategy meetings with all the portfolio managers and traders, which allows us to give everybody a much more current view on what has been

happening in our individual sectors and the credit research that we have.

We have a staff of ten analysts who have a weekly meeting where they update everyone in terms of the credits in their individual sectors. There is quite a bit of communication so that we can make mid-course corrections if that turns out to be necessary.

The analysts will also summarize their findings in a report on each individual issuer that is available in our database for everybody to refer to. Once the analyst gets a sense of how a specific credit will fare, they will contact the portfolio manager about that specific credit and discuss the necessary steps to be taken.

One thing to be pointed out is that we have our credit analysts sit on the trading desk, in the constant flow of information – being providers of information as well as receivers of information with the traders.

To sum up, the analyst does the homework, shares the information and discusses the options with the portfolio manager, but at the end of the day, it is up to the portfolio manager to make the final decision on the Fund's assets. That wraps up our research process.

How do you do your portfolio construction?

We want to have a portfolio that is well diversified and it depends on the sector. The diversification that we do in the Treasury space is very different from the diversification we would do in the corporate bond portion of the portfolio.

We do not seek to have a lot of concentration risk and idiosyncratic risks. In the corporate space, our typical holding will be on the order of 0.25% to 0.5% per issuer, depending on how we feel about that specific issuer and that specific maturity. On the other hand, we might have holdings of 2% or 3% in Freddie Mac or Fannie Mae mortgage-backed securities or any type of agency backed bonds.

After we get through the view on the macroeconomy in our quarterly review, we then go ahead and see which sectors we

should overweight or underweight relative to our benchmark given our view. After we arrive at that decision, the portfolio manager will work with both the credit analysts and the traders to find the best issues in that given sector to fill the bucket or to sell those issues we find to be rich at that point.

The benchmark index serves as our guide. We need to have an opinion on a given sector but since we are big believers in diversification and the benefits of diversification, our view would be moderated by that. Even if we find a sector is egregiously rich, we will not ever be totally out of the sector but we will be substantially underweighted. Should our assessment prove to be somehow wrong, we wouldn't want to be totally out of that sector.

What are the risks perceived in the fund and what measures do you take to control them?

Our decision to be totally duration neutral relative to whatever index we are managing against is one way of controlling risk relative to the benchmark. We do not think we can add substantial value through rate anticipation.

Having access to daily reports that monitor our exposures and concentration risks on a daily basis, we know the exposures on a name basis and on a sector basis. We know that every single day relative to our benchmark, so we know exactly how the fund portfolio is positioned relative to the index.

What are the challenges faced when investing in a corporate bond?

It is certainly the credit parameter. The fundamental question is whether this entity will be able to pay off the bond in five or ten years from now. That is exactly what justifies our business decision to invest in a team of independent analysts. In short, the real challenge is to have a deeper understanding of credit risk.

Why do you think duration is not the way to add alpha?

Generally speaking, the idea of providing our shareholders with a core holding in the US fixed income market has an implied requirement to it – that if the duration of this core holding in the marketplace is 4.5 years, we believe that our shareholders would not want us to take on additional interest rate risk and maintain a portfolio of seven years.

It has been demonstrated that over the long term, interest rate anticipation has not been the best or most reliable way of adding alpha and in contrast it is the asset allocation decision that gives the most consistent outperformance.

What is the significance of the term “low duration” in the fund?


We are trying to communicate that this is a mutual fund that is a short duration version of our Investment Quality Bond Fund. Prior to the creation of the Low Duration Bond Fund, we only had two options in taxable fixed income - a money market fund and a well-diversified intermediate bond fund with duration of 4.5 years - so we thought that offering a new fund that would roughly split the duration difference and give investors a third choice would be helpful and that's exactly why we started this fund.

Our shareholders would earn greater yields in this fund than what they would earn in a money market fund. In addition, some shareholders are concerned about rising rates and because nobody wants to take on the interest rate risk of a long duration investment in that environment, this fund provides an attractive alternative on that front too.

How much do you rely on rating agencies' work?

We rely on our own independent credit research work, but we cannot ignore the role of the national rating agencies. For example, many investors want to know the average credit rating of the Fund, so we do need to incorporate their ratings.

However, our guiding mantra has been to do our own homework and not rely on the credit rating agencies. This was valid for us even before the '07, '08 debacle. That's why we have that staff of ten people to do all the independent work.

When we look at assets for our funds, there is no substitute for doing one's own homework. We believe it is very worthwhile to dig into the collateral quality and any structural features that a given bond might have, so we ask the credit analysts to do the deep dive. 

RS Low Duration Bond Fund

Symbol	RLDAX
Website	www.rsinvestments.com
Address	RS Investment Management Co LLC 388 Market Street, Suite 1700 San Francisco, CA 94111
Telephone	800-766-3863
Inception	07/30/2003

PORTFOLIO	
Total Net Assets *	\$81.8
Average Coupon Percent	3.71
Average Duration (years)	1.8
Effective Average Maturity	1.75
Nominal Average Maturity (years)	5.86
Maturity Method	F

INVESTMENT INFORMATION	
New Investment	Open
Min Initial Investment	\$2,500
Min Subsequent Investment	\$100
Min Initial IRA Investment	\$1,000

RISK (AGAINST BARCLAY 1-3 GV/CRED IX - 3 YEARS)	
Alpha	0.11
Beta	0.52
R-Squared	0.49
Ann Std Deviation	1.27
Sharpe Ratio	1.63

RETURNS VS. BARCLAY 1-3 GV/CRED IX		
	RLDAX	Index
1 Year (Cum.)	5.60%	4.72%
3 Years (Ann)	4.92%	5.43%
5 Years (Ann)	3.72%	4.10%

FEES AND EXPENSES	
Max Sales Charge - Front**	2.25%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee**	0.00%
Total Expense Ratio	0.80%

PORTFOLIO MANAGER	
Howard Chin	January 1998
Robert Crimmins	May 2004

*millions ** for amount invested less than \$100,000
08/31/2009; Source: Company Documents; Lipper

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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.

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RS Low Duration Bond Fund (RLDAX) Performance[†]
(Average Annual Total Returns as of 9/30/09)

	Third Quarter 2009	1-Year	3-Year	5-Year	Since Inception (7/30/03)
RS Low Duration Bond Fund, Class A					
without sales charge	2.20%	6.32%	4.91%	3.83%	3.47%
with maximum sales charge	-0.10%	3.89%	4.10%	3.36%	3.09%
Barclays Capital U.S. Government 1-3 Year Bond Index ¹	0.85%	4.40%	5.34%	4.17%	3.69%

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 1.23% for the Class A shares. Class A performance quoted "with maximum sales charge" reflects the current maximum sales charge of 2.25%. 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. 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. Total return figures reflect an expense limitation in effect during the periods shown; without such limitation, the performance shown would have been lower. Performance results assume the reinvestment of dividends and capital gains. The return figures shown do not reflect the deduction of taxes that a shareholder may pay on Fund distributions or the redemption of Fund shares. Current and month-end performance information, which may be lower or higher than that cited, is available by contacting RS Investments at 800-766-3863 and is frequently updated on our Web site: www.RSinvestments.com.

¹ The Barclays Capital U.S. Government 1-3 Year Bond Index is an unmanaged index that is generally considered to be representative of the average yield on U.S. government obligations having maturities between one and three years. Unlike the Fund, the index does not incur fees or expenses.

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