RS | investments

First Quarter 2012 Mutual Fund Commentary
RS International Growth Fund

Investment Environment

It is rare to be able to discern important turning points among the torrent of news and events that confront us. But two developments in recent months suggest to us that the worst possible outcomes of the financial crisis have been averted, and may signal brighter days ahead: decisive policy intervention by the European Central Bank to stabilise the Eurozone, and the emergence of a sustainable recovery in the US economy. In response, global stock markets have staged an impressive rally from the dismal lows of September, but with the notable exception of the US, they remain below the levels of even a year ago. Whilst many deep-seated problems still demand resolution, we believe greater optimism is warranted.

The ECB's new and improved Long Term Refinancing Operation (LTRO) was designed to prevent another seizing up of credit markets, a Lehman-esque disaster that was becoming more likely over the winter as confidence in Europe's globally connected banks eroded at an alarming rate. The LTRO has allowed the region's banks to borrow an unlimited amount, for three years, secured against collateral determined by their own local central bank. Complemented by the injection of dollar liquidity by the Federal Reserve, the LTRO achieves two important goals: it breaks the downward spiral of banking collapse, recession and sovereign debt crisis; and it sends the signal that European policymakers and politicians will, after a delay that was excruciating for financial markets, do enough to preserve the euro area. Given the depressing influence the Eurozone crisis was exerting on business and investor confidence all around the world, this seems highly significant.

The need to avoid moral hazard has played a central role in Europe's sovereign debt drama. Making financial support contingent on good behaviour has continuously roiled the markets but for the most part seems to be working. The ousting of Italian Prime Minister Berlusconi can be attributed to his failure to comply with the reform agenda, and subsequent indirect central bank support for the Italian bond market reflects approval of the reforming efforts of the new Monti government. Equally, the signing of the European fiscal pact has encouraged the release of funds from the centre to the periphery. No doubt pressure will need to be applied again – almost immediate slippage in Spain's deficit target is a case in point – but the direction of travel is constructive.

The ECB's programme is not meant to solve Europe's problems, but to buy time for budgets to be stabilised and pro-growth reforms to be enacted. The German Finance Minister has repeated the old maxim "never let a good crisis go to waste." He should be encouraged by the progress that is being made in changing restrictive labour and retail practices, particularly in Southern Europe. For example, Italy is liberalising its retail laws, allowing local wage bargaining and addressing the connected issues of tax avoidance and government malpractice; Spain is reforming its labour market and allowing opt-outs of collective wage bargaining; France is raising its retirement age. The latest Greek package may or may not work, and the country's difficulties stand as a warning to the rest of Southern Europe. However, Greece has managed to restructure its debt without causing a global collapse: a pleasant surprise, given the attention the market has devoted to worrying about Greek default in the past couple of years.

We believe that it is equally important that while the competitiveness of Southern Europe is being sharpened by these reforms, German workers are enjoying strong wage growth: the other and

equally necessary side of Europe's rebalancing process. The benefits of these reforms will only be felt in the long term but the examples of Sweden and Germany suggest they may be worth the wait.

Across the Atlantic, the recovery of the US job market has started to gather pace in recent months. In an environment where companies have exceptionally strong finances, and consumers have felt under pressure, an improvement in employment is clearly critical to recovery. As wage levels in the developing world have risen and American companies have restructured, American competitiveness has improved.

The development of the shale gas industry contributes to this industrial recovery, lowering energy costs and allowing the US to move towards energy independence in the medium term. Last year marked the first year that the US was a net exporter of petroleum products since 1949. The ongoing dynamism of Silicon Valley and its generation of exceptional companies also remains a great competitive advantage for America.

Portfolio review

Although the Fund is constructed on a bottom up basis with companies being selected on their individual merits, inevitably some underlying themes do emerge. One such theme has been the growth in the consumption of luxury items. As levels of disposable income have risen in Asia, there has been a corresponding increase in demand for luxury goods with a strong brand heritage, across a range of products from handbags, through clothes and jewellery to high performance sports cars. This trend is all about conspicuous consumption and the implicit association with success; it is used as means of demonstrating (aspirational) social status. The Fund already invests in PPR (2.78%), Richemont (2.79%) and Swatch (0.52%). Because of the strength of the heritage element and the power of the attraction to consumers of buying into something more than the item itself, we believe that the owners of these brands have strong and defensible competitive positions in growing markets, making them good businesses able to command attractive margins.

Our recent purchase of the Italian auto maker Fiat (0.89%) for the Fund continues this trend through its ownership of one of the most iconic luxury car brands in the world: Ferrari, a brand with a great heritage and a name synonymous with the word 'supercar'. This is undoubtedly the most attractive and valuable asset in the automaker's stable. Ferrari has consistently been a profitable part of the Fiat group, but what appeals to us is the potential for production to rise rapidly for some time, as happened at Porsche (0.84%) a few years ago. If this were to happen, the Fiat Group's profits would be transformed, and the company would be viewed very differently by the stock market.

The Fiat purchase also reflects our view that the reforms being undertaken in Italy will be beneficial in the long term. Currently, the market seems to discount the potential for Fiat's decidedly less glamorous mass market auto businesses, which include Chrysler as well as its own name brand, to turn around. The Italian 'assets' may embody the worst of the country, operating at only one-third capacity, but the company, like the Italian Government, has been pushing through reforms to existing working practices which should pay dividends in the long run. At the start of the year, Fiat withdrew from all existing national collective agreements, closed some of its factories and renegotiated employment contracts at the individual plant level, using the threat of selective investment. These changes should allow Fiat to become more competitive. In America, successful labour negotiations at Chrysler may be giving rise to a comparative cost advantage, certainly when compared to Toyota and Ford, and this auto business will likely benefit from the current economic recovery. While we are under no illusions about the challenges facing the US auto industry, the reforms taking place here and in Fiat's home country could help to make a material improvement in the company's performance.

The strength of management within a company is always a key factor we consider in any investment case. We have confidence in the abilities of CEO Sergio Marchionne and Chairman John Elkann to execute the necessary reforms to change dramatically the prospects for the group as a whole.

We have been considering the implications of a better than expected economic performance in Europe, combined with the ECB's LTRO activities. Potentially this could bolster the banks and their share prices may rally. In the past, we have not invested in many of the large European banks as we simply did not see the majority of them as growth companies. Unless we can see specific growth drivers from here for any individual bank, this will not change. Instead, we have preferred to invest in a range of financial companies with exposure to areas of the world with low levels of financial services penetration and rising incomes which should allow them to grow their business. These include Credicorp in Peru (0.62%), Garanti Bank in Turkey (1.48%) and the insurance giant Prudential, which derives a substantial portion of its profit growth from Asia. Over the quarter, we decided to invest in AIA (1.02%), the other leading insurance business in Asia. Hong Kong is AIA's most important market, generating 30% of new business profits. Growth in this market has continued apace, with the latest five year new business premium compound annual growth rate topping 16%. This is driven not only by wealth creation in the territory itself, but also by demand from the Chinese mainland for healthcare products and renminbi asset diversification through unit linked investment products outside China.

The company's long-term growth potential is further supported by the ongoing progression of regional economies such as Thailand, Vietnam and Malaysia, where we expect demand for a variety of financial products to grow well in excess of GDP. Again, the strength of management is an important feature of the investment case. Mark Tucker, formerly at Prudential, joined AIA in 2009, looking to turn the company around. His considerable experience, particularly in the Asian markets, should make him invaluable in developing AIA.

Performance Review

For the first quarter of 2012, RS International Growth Fund (Class A Shares) returned 12.95%, outperforming the 10.98%% return of the MSCI EAFE Index[1] and the 12.10% return of the MSCI EAFE Growth Index[2].

The Fund's holding in Novo Nordisk (2.24%), the pharmaceutical company specialising in diabetes, performed well as it released exceptional operating results for 2011. The company is benefiting from

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 1.60%. 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. 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.

Performance quoted represents past performance and does not guarantee future results. The Fund is the successor to The Guardian Baillie Gifford International Growth Fund; performance shown includes performance of the predecessor fund for periods prior to October 9, 2006. Please refer to the most current Fund prospectus for complete details on expenses including fees and also 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.

an entrenched market position, with a trusted reputation, in an industry that is growing as obesity spreads.

More widely, we do not invest in any of the large pharmaceutical companies; this was beneficial for the Fund's relative returns over the quarter. We believe their large profit pools are not sustainable due to the global need, particularly in the US, to cut health care spending. However, this is not to say we think the health care sector is not an interesting growth area. We are excited about the revolutionary impact of technology and innovation on the industry. The way patients will be assessed and treated in the future will be vastly different from today - be this from "personalised medicine" helping provide more suited medication for patients, to machinery that is improving the way doctors carry out operations. The pace of change in this industry is remarkable and we continue to watch for companies in this area with a sustainable competitive advantage.

The Fund's Chinese internet stocks rallied strongly over the quarter. Baidu (5.33%) and Tencent (2.95%) performed particularly well as their long term growth path continued. They are continuing to increase their user bases and importantly are at the early stages of monetisation, meaning each increase in spend per user has a dramatic impact on profits. Consideration of their strong fundamentals, combined with our positive long term outlook for China, makes us believe their future success and growth should continue for many years to come.

Moving further East, yet remaining with the Fund's technology holdings, Japanese internet stocks Gree (1.43%) and Rakuten (2.74%) underperformed. Gree has suffered following media speculation that the addictive nature of its games may lead to some unhelpful industry regulation. Gree appears to be making sensible moves including limiting amounts younger users can spend. Meanwhile, Rakuten fell despite the absence of any negative news flow; its recent underperformance should be seen in the context of longer term outperformance.

Over the quarter Tesco (0%), the global supermarket chain, underperformed as it released disappointing 2011 results. We have sold out of the Fund's holding owing to long term concerns over its future growth prospects. We have worries that Tesco's UK business will continue to have its profits squeezed as a result of high competition and a struggling customer base. Moreover, we do not believe its overseas operations are sufficient to offset the problems in its home market. Tesco is performing strongly in markets such as South Korea and Thailand; however, it has loss making operations in the US and is only breaking even in Eastern Europe. Overall we feel the best of Tesco's growth may now be behind it.

Investment Outlook

Our view of the long-term trends in the world economy has been consistent for some time. The sustainable growth of China, the emergence from poverty and entry into the global economy of hundreds of millions of people in the developing world, and the changes being wrought by accelerating technological progress, are interwoven themes that form the backdrop to our stock picking efforts. We have not shared the market's concern that an apocalyptic disaster, ranging from a Chinese property collapse to a US default or the demise of the euro, would overwhelm these themes and push the world into recession or worse. We have no doubt the market will continue to search for and worry about these tail risks; potential conflict with Iran and renewed anxiety about a Chinese slowdown are currently in focus. But we have become more optimistic that the positive longer-term influences on equities will shine through.

Companies, consumers and investors have all been similarly oppressed by the uncertainty, volatility and cliff-hanging dramas of the last five hard years, and have changed their behaviour accordingly. However, as evidence of economic recovery builds, there will more than likely be a corresponding revival of animal spirits. History suggests this could well be the necessary catalyst for a rise in capital

expenditure, hiring, consumption and risk-seeking investment. The resulting recovery could be particularly sharp, as there is so much scope for confidence to rise.

We thank you for your continued support.

Sincerely,

James Anderson Co-Portfolio Manager	Tom Coutts Co-Portfolio Manager	Tom Record Co-Portfolio Manager
David Salter Co-Portfolio Manager	Kavé Sigaroudinia Co-Portfolio Manager	Nick Thomas, CFA Co-Portfolio Manager
Sarah Whitley Co-Portfolio Manager		

As with all mutual funds, the value of an investment in the Fund could decline, so you could lose money. 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. These risks are even greater when investing in emerging markets.

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 March 31, 2012.

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.

Regional Allocation
(As of 3/31/12)

Region	Allocation
European	38.8%
UK Equity	20.4%
Emerging Markets	19.6%
Developed Asia	19.2%
Cash	2.0%

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

Company	Country	Percentage of Total Net Assets
Baidu	China	5.33%
Atlas Copco	Sweden	3.43%
Tencent Holdings	China	2.95%
Standard Chartered	United Kingdom	2.79%
Richemont	Switzerland	2.79%
Ppr	France	2.78%
Bhp Billiton	United Kingdom	2.75%
Rakuten	Japan	2.74%
Prudential	United Kingdom	2.64%
Inditex	Spain	2.61%

Performance
(Average Annual Total Returns as of 3/31/12)

	First Quarter 2012	1-Year	3-Year	5-Year	10-Year	Since Inception[4]
RS International Growth Fund, Class A						
without sales charge	12.95%	-4.99%	20.58%	-0.93%	5.45%	5.89%
with maximum sales charge	7.59%	-9.52%	18.63%	-1.89%	4.94%	5.62%
MSCI EAFE Index[1]	10.98%	-5.31%	17.68%	-3.04%	6.16%	6.43%
MSCI EAFE Growth Index[2]	12.10%	-3.37%	18.14%	-1.53%	5.87%	4.92%

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

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 1.60%. 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. 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.

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1 The Morgan Stanley Capital International (MSCI) EAFE (Europe, Australasia, Far East) Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. Unlike the Fund, the index does not incur fees or expenses.

2 The Morgan Stanley Capital International (MSCI) Growth Index for Europe, Australasia, and Far East (EAFE) is generally considered to be representative of international stock market activity. Index results assume the reinvestment of dividends paid on the stocks constituting the index. Unlike the Fund, the index does not incur fees or expenses.
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 February 16, 1993.

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