

## Third Quarter 2011 Mutual Fund Commentary RS Small Cap Growth Fund

### Market Commentary

Equity markets suffered from pronounced downward volatility in the third quarter, as concerns over the global economic outlook, the ongoing debt crisis in Europe, and political uncertainty in Washington dampened investor appetites for risk. Economic news was particularly disconcerting, as continued high unemployment and signs of widespread weakening in spending and manufacturing activity raised fears of another recession. The recent environment was especially challenging for small cap stocks, which suffered their second worst September performance on record (since Russell 2000 Index inception) according to a recent Bank of America Merrill Lynch report. For the quarter, small cap stocks, as represented by the Russell 2000<sup>®</sup> Index<sup>1</sup>, lost 21.87%, and were down 17.02% year-to-date. Global economic uncertainty took a sharp toll on energy and raw materials stocks, which were the weakest performing areas of the Russell 2000 Index for the quarter. Weakness was widespread, however, and risk averse investors also sold out of higher multiple, higher beta secular growth companies, particularly in the technology sector, with the highest beta stocks in the Russell 2000 Index off 35% for the quarter. More defensive sectors such as utilities, consumer staples, and health care held up somewhat better than the broader index.

### Performance Review

For the three-month period ended September 30, 2011, RS Small Cap Growth Fund (Class A Shares) declined 22.87%, underperforming a 22.25% decline by the benchmark Russell 2000<sup>®</sup> Growth Index<sup>2</sup>. The Fund's performance relative to the index was aided by stock selection in the materials and utilities sectors. Stock selection in the producer durables and financial services sectors was particularly detrimental to the Fund's relative performance for the period. For the year to date period through September 30, the Fund has declined 12.57%, well-outperforming the 15.57% decline by the benchmark index.

### Portfolio Strategy

RS Small Cap Growth Fund is managed according to our philosophy that long-term share price appreciation is driven by sustainable earnings growth. We are focused on innovative companies whose core business can transition them from being a small market-cap company to a mid- or even large- capitalization company over time. We find innovation among products or services that are

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 for the Class A Shares is 1.47%. 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](http://www.RSinvestments.com).

Please refer to the most current Fund prospectus for complete details on expenses including fees and also 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.

growing organically, creating new markets or taking market share away from existing companies, focusing on those that we believe will achieve high margins, high returns on equity, and a subsequent appreciation in business value regardless of the underlying market environment.

The Fund is managed by three co-portfolio managers who have worked together for over ten years, and who along with four research analysts serve as sector specialists. We conduct over 2,000 company meetings each year, through in-person meetings, conference calls, trade shows, etc. We then back up our findings through discussions with industry leaders and third-party sources, as well as conducting proprietary financial modeling.

We are long-term investors and seek to establish definable “anchor points,” or quantifiable metrics indicating a company’s potential long-term growth trajectory. Anchor points allow us to maintain our research focus as a company executes its business strategy. We find these tools invaluable in aligning our research with management’s stated goals and in preventing distraction caused by short-term stock price movements and inevitable market volatility.

Anchor points arise out of our high-level discussions of a company’s long term capabilities and performance goals over three to five years. The RS Growth Team translates these goals into quantifiable metrics to be evaluated over the company’s growth cycle. These long-term anchor points serve as guide posts to help us measure a company’s progress toward its goals, regardless of what is taking place in the overall market.

In constructing the portfolio, we combine investments in companies with established business models and demonstrated financial success with exposure to promising and developing companies that are in the earlier stages of their growth cycle. We believe that this multi-tiered approach allows us to capitalize on the growth potential across the small cap spectrum, while also managing risk and ensuring a well diversified portfolio for our investors.

With respect to risk, we seek a *minimum* two-to-one ratio of upside potential to downside risk potential for each investment over the next 12-18 months. We measure these scenarios using proprietary financial models that typically look three years out. At the portfolio level, we conduct weekly formal risk-management meetings.

### **Portfolio Review**

The recent quarter was characterized by considerable volatility. In adhering to our disciplined risk management practices and our strategy of blending promising and developing small cap investments with holdings in companies with more established market positions and proven earnings performance, we reduced our weighting in those companies that we characterize as promising, given our view that that extreme market movements would adversely skew the risk/reward profile the Fund. While we continue to favor the long-term characteristics of our promising small cap companies, we believe that it is prudent in the current market environment to hold companies that we feel possess more proven business models; those companies with mid teens margins and return on equity, many of which produce high rates of recurring revenue.

The Fund’s performance relative to the Russell 2000 Growth Index was supported by stock selection in the healthcare sector, where the underlying fundamentals remain promising in a landscape characterized by rising healthcare costs, an aging population, and the emergence of 30 million newly insured healthcare participants created under healthcare reform. We continue to focus on innovative companies that we believe offer sustainable competitive advantages and the potential for superior long-term earnings growth. At the same time, we seek to avoid exposure to companies with government reimbursement or regulatory risk.

Within healthcare, Pharmasset (1.63% position as of 9/30/2011) was a strong positive performer for the Fund, both in the third quarter and year-to-date. This company is focused on developing next generation treatments for hepatitis C (HCV), a condition that affects approximately four million people in the United States, making the addressable market quite large. The existing treatment regimen for HCV relies heavily on the use of interferon, a toxic substance with significant side effects. Additionally, few HCV sufferers in the U.S. are currently receiving treatment for the disease. Against this backdrop, we believe there is a huge potential market for Pharmasset's next generation, interferon-free drugs which are given orally rather than intravenously. As more trial results become available, the company's compounds are so far showing not only high levels of efficacy but also promising safety profiles. We believe that Pharmasset's next generation compounds will have a primary role in any drug combination offered to HCV patients. Given the company's continued progression toward our anchor points, we remain constructive on its long-term prospects.

The Fund's relative results in the third quarter were also supported by our investments in a number of specialty retailers that continue to report favorable sales trends and profitability, and are also progressing towards our anchor points with respect to store traffic and market share gains within the addressable market. We have also focused on consumer companies that benefit from recurring consumer purchases of items such as vitamins or cosmetics, which we believe are less susceptible to fluctuations in discretionary spending. One company that held up well relative to its sector during the quarter is Ulta Salon, Cosmetics, & Fragrance (1.60%), a stand-alone retailer of beauty supply and cosmetic products. Ulta continues to report solid revenue performance as it capitalizes on its store expansion plans and unique retailing strategy. Ulta has approximately a 10% market share in the \$10 billion specialty retail market, and our analysis suggests that its market share could be much greater. The company attracts more customers to its stores, luring them away from department stores and other incumbents, by carrying a broad range of beauty and salon products, from discount lines to higher-end brands. Revenue growth has been driven by traffic, rather than just by raising prices, a trend that we find to be favorable among retailers.

In the technology space, relative performance was aided by NetLogic Microsystems Inc. (0.00%), a supplier of communications semiconductors that was purchased by Broadcom Corp. (0.00%), a maker of telecommunications chips used in television set-top boxes, for about \$3.7 billion in cash, a 57% premium to its market price.- Broadcom reportedly sought NetLogic's technology as a way to extend and fill out its own communications portfolio, and this purchase underscores the continued interest and growth potential in the networking equipment and components space. Data traffic is slated to expand 30 times by 2015, according to industry giant Cisco Systems (0.00%). The massive investment in new infrastructure needed to accommodate this swelling traffic will, in our view, create substantial opportunities for networking equipment manufacturers, as well as for companies that make processors and components integral to this equipment. Other beneficiaries will be suppliers of state-of-the-art storage infrastructure and data security solutions.

Our interest in this area continues to influence a number of our investments in the technology space, as we have identified companies that we believe possess compelling technological capabilities and attractive market opportunities. However, during a volatile quarter, many smaller cap, growth-oriented technology shares failed to find favor with risk-averse investors. As a result, a number of the Fund's higher beta, higher growth technology investments sold off despite their solid underlying fundamentals and continued strong growth prospects. One of the Fund's largest individual detractors for the period was Fortinet (1.34%), a stock that had performed very well for the Fund in the first half of the year. Fortinet makes advanced unified threat management solutions that act as very fast and thorough firewalls, enabling data networks to screen out cyber threats and other intrusions. Cyber attacks are becoming increasingly common and sophisticated, making IT security more important and complex than ever. Given these dynamics, we believe that enterprise spending on data security will continue, even in a slower growth environment. Given what we view as Fortinet's superior and very competitively priced products, we believe it is positioned to significantly grow its share.

We believe that the dynamics driving long term technology trends remain in place, and have been reassured with the progress that our holdings in the sector are making relative to our anchor points. Nonetheless, we recognize that a more volatile and risk averse investment environment may prove challenging for stocks with higher growth profiles. One company that was challenged in this environment was RealD (0.96%), a provider of patented, 3D technology marketed to movie theaters. The stock has struggled recently, due in part to a slower-than-expected roll-out of 3D technology in theaters nationwide. The company has also faced questions over whether consumers or theater owners would be willing to purchase the required 3D glasses, especially in a weaker economic environment.

In the producer durables equipment area, we continue to focus on secular growth companies that we believe are less susceptible to commodity price fluctuations. Unfortunately, the recent market environment has been difficult for any company with perceived near-term economic exposure, including our investment in Commercial Vehicle Group (0.87%). An innovative manufacturer of seat and harness systems and other components for the commercial trucking industry, Commercial Vehicle Group first caught our attention because of its unique product lines, as well as the steps its management had taken to pay down debt and strengthen the company's financial position. Economic concerns have weighed on the company's share price performance in recent quarters, detracting from the Fund's relative performance. Nonetheless, we continue to believe in the company's long-term earnings potential. The U.S. commercial trucking fleet is aging, and we believe that Commercial Vehicle Group is well positioned to capitalize on the eventual replacement cycle. The company also has substantial opportunities abroad, especially in the fast growing Chinese market.

### **Outlook**

As we look ahead, we believe that the equity market may remain volatile as investors await more clarity on the global economic outlook. We also believe that we may be entering a period of slower growth during which we will continue to focus on what we view as more proven small cap companies with mid teens margins and returns on equity, and high rates of recurring revenue. In this environment and as long-term investors, we believe that it is critical to look beyond short-term cyclical factors and position the Fund to benefit from innovations and secular growth opportunities across a variety of industries.

Thank you for your continued investment.

Sincerely,



Steve Bishop  
Co-Portfolio Manager



Melissa Chadwick-Dunn  
Co-Portfolio Manager



D. Scott Tracy, CFA  
Co-Portfolio Manager

As with all mutual funds, the value of an investment in the Fund could decline, so you could lose money. Investing in smaller companies can involve risks such as having less publicly available information, higher volatility, and less liquidity than in the case of larger companies. 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. Investments in technology companies may be highly volatile.

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 September 30, 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](http://www.RSinvestments.com).***

### **Sector Allocation<sup>3</sup>**

(As of 9/30/11)

Health Care	22.41%
Technology	18.48%
Consumer Discretionary	17.07%
Producer Durables	11.20%
Financial Services	8.60%
Materials & Processing	7.47%
Energy	7.29%
Consumer Staples	1.61%
Utilities	1.48%
Cash	4.41%

### **Top Ten Holdings<sup>4</sup>**

(As of 9/30/11)

BioMarin Pharmaceutical, Inc.	2.14%
HEICO Corp., Class A	2.07%
Tractor Supply Co.	1.69%
Catalyst Health Solutions, Inc	1.65%
LKQ Corp.	1.65%
Pharmasset, Inc.	1.63%
RBC Bearings, Inc.	1.60%
The Ultimate Software Group, I	1.60%
Ulta Salon, Cosmetics & Fragra	1.60%
comScore, Inc.	1.59%

## Performance

(Average Annual Total Returns as of 9/30/11)

	Third Quarter 2011	1-Year	3-Year	5-Year	10-Year	Since Inception <sup>5</sup>
RS Small Cap Growth Fund, Class A						
without sales charge	-22.87%	1.00%	7.15%	2.00%	3.91%	12.29%
with maximum sales charge	-26.54%	-3.80%	5.42%	1.01%	3.40%	12.06%
Russell 2000 <sup>®</sup> Growth Index <sup>2</sup>	-22.25%	-1.12%	2.07%	0.96%	5.45%	7.31%

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 for the Class A Shares is 1.47%. 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](http://www.RSinvestments.com).

Please refer to the most current Fund prospectus for complete details on expenses including fees and also 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.

**1** The Russell 2000<sup>®</sup> Index measures the performance of the 2,000 smallest companies in the Russell 3000<sup>®</sup> 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. Unlike the Fund, the index does not incur fees or expenses.

**2** The Russell 2000<sup>®</sup> Growth Index is an unmanaged market-capitalization-weighted index that measures the performance of those companies in the Russell 2000<sup>®</sup> Index with higher price-to-book ratios and higher forecasted growth values. (The Russell 2000<sup>®</sup> Index measures the performance of the 2,000 smallest companies in the Russell 3000<sup>®</sup> 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.

**3** 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.

**4** Portfolio holdings are subject to change and should not be considered a recommendation to buy or sell individual securities.

**5** Class A shares inception date November 30, 1987.

Distributed by: Guardian Investor Services LLC (GIS), 7 Hanover Square, New York, NY 10004.

Not a Deposit	Not FDIC or NCUA Insured	May Lose Value	No Bank or Credit Union Guarantee
------------------	--------------------------------	----------------------	---

GIS is a member: FINRA, SIPC.

©2011 RS Investment Management Co. LLC

CO1141QL\_SCGF