

## First Quarter 2010 Mutual Fund Commentary RS Partners Fund

### Performance and Market Commentary

For the first quarter of 2010, RS Partners Fund (Class A Shares) generated a return of 11.33% versus 10.02% for the benchmark Russell 2000<sup>®</sup> Value Index<sup>1</sup>. The Fund's results during the quarter were positive both in absolute terms and relative to the benchmark, which the Fund outperformed by 131 basis points. Similar to 2009, this outperformance was also very strong on a risk-adjusted basis.

In our year end 2009 commentary we described a "risk rally" that existed for most of the year, during which the best-performing stocks, across all capitalization ranges, were generally those with lower quality businesses and/or elevated levels of financial leverage. We cited Bernstein Research which found that the lowest quality stocks outperformed the highest quality stocks by over 50% (or 5,000 basis points) from March to December of 2009<sup>2</sup>. It now appears that this "risk rally" persisted into the first quarter of 2010. By way of example, the lowest Return on Equity (ROE) stocks within the Russell 2000<sup>®</sup> Value Index outperformed the highest ROE names by 389 basis points during the first quarter of 2010. Moreover, nonearning companies within the index outperformed the benchmark by 429 basis points during the quarter<sup>3</sup>.

We continue to focus on companies that are going through positive structural changes that will lead to improving returns on invested capital. Our goal of limiting losses and allocating to companies with asymmetric risk-reward profiles is an integral component of the RS Value investment process. Long-time readers know that we seek to position our shareholders' capital to lose less in down markets, and to keep pace with the index during periods of dramatic market price appreciation.

### Portfolio Positioning

#### *Financials*

Over the past year, the Fund's exposure to financial services steadily increased as we became increasingly more constructive on the sector. This trend persisted during the first quarter of 2010, as we continued to patiently and opportunistically deploy incremental capital toward those financial

services companies that we felt possessed solid capital positions, stable and reliable funding sources, strong management teams, increasing returns on capital, and downside protection.

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 1.53%. Please refer to the most current Fund prospectus for complete details on expenses including fees. 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. 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. Current and month-end performance information, which may be lower or higher than that cited and is available by contacting RS Investments at 800-766-3863 or visiting [www.RSinvestments.com](http://www.RSinvestments.com).

Over the past year we have been slowly and cautiously building our banking exposure, and we continue to be very discriminating relative to the Fund's bank investments. That said, it is our view that the banking industry continues to structurally improve. We continue to see signs supportive of our thesis that credit losses may be peaking, which will be the starting point for structural improvements in the return profiles of credit based financial institutions. Furthermore, we believe that the elimination of irrational competitors and a return to more economic pricing of credit risk will lead to structurally higher returns for those companies that are best positioned to weather the current economic environment. In our bank investments, we continue to look for businesses with solid deposit franchises and sound capital ratios that generate strong pre-provision cash flows. Moreover, we need to be able to assess potential credit losses while seeking to purchase our investment at or near a stressed tangible book value. In addition, we expect that the better positioned banks will garner significant market share from weakened competitors.

The Fund's investments in the financials sector contributed positively to both the Fund's full year 2009 and first quarter 2010 results and we are pleased with the positioning of our current financial services investments. In general, valuations within financials remain relatively attractive despite the significant move that the sector has enjoyed off of last year's bottom. Looking forward, we would expect the portfolio to continue its shift away from REITs and property & casualty insurance in favor of banks and life insurance. With returns on new business improving at select banks and life insurance companies, we remain interested in those companies that possess sustainable longer-term business models.

#### ***Consumer, Business Services, Health Care, and Technology***

We continue to allocate capital toward companies with less cyclical exposures that are undergoing company-specific changes that should lead to improving returns. As detailed in last quarter's commentary, healthcare was an area where we were especially active in allocating capital during 2009. We continue to remain cautious regarding more discretionary consumer-related businesses as we feel that the U.S. consumer may face ongoing challenges, especially in regards to the housing market. With the U.S. government continuing to prop up the mortgage market, we remain defensively positioned with respect to the consumer as we await further visibility regarding what impact the withdraw of this artificial support will have on home prices. Therefore, to the extent that we make investments that are impacted by the consumer, we seek businesses that serve less-discretionary needs or have more recurring cash flow characteristics.

#### ***Hard Assets***

The hard asset pod is divided between businesses that we generically label as "industrials" and those falling under the natural resource heading. The primary difference between the two groups relates to the laws of mean reversion. In industrials, processing and service oriented businesses excess returns are typically competed away over time, which is why we focus on *improvements* in returns on invested capital when assessing investment opportunities. In contrast, returns on capital in the natural resource space are a function of where a company's producing assets sit on a supply cost curve. Effectively, returns are typically driven by the "quality of the rock" and, because geology doesn't change over our 3-5 year investment time horizon, returns on capital in the natural resource space are not often subject to mean reversion. Due to this fundamental difference, each segment deserves its own separate commentary.

While the operating environment for many industrial companies has improved considerably over the past year, we remain concerned about most companies' ability to generate positive pricing in a world where significant excess labor and manufacturing capacity persists. As a result, we have slanted our exposure towards the higher quality, more durable franchises within the industrial landscape. Interestingly, these businesses remain available in the market at much more attractive valuations than their more speculative peers, due in part to the "junk" rally that characterized the market over

the past 12 months. We like purchasing these businesses at steep discounts to warranted value, as we believe that our downside risk remains limited. Even with recent stock price increases, we remain convinced that the opportunity to own defensible, differentiated business models, run by outstanding management teams, will set the foundation for attractive future returns.

Our objective in managing investments within natural resources is to optimize risk adjusted returns across a full commodity price cycle. We do not believe that we have an edge in speculating on commodity price changes. Instead, we believe that we can best manage the risks inherent in natural resource investing by identifying and purchasing what we call “advantaged” assets. Advantaged assets sit at the bottom of a reasonably steep supply cost curve and can generate excess returns on capital at any point in a commodity price cycle. We accept that this approach may not maximize returns when commodity prices are rising rapidly. The offset is that in volatile or declining markets, and more importantly across a commodity price cycle, we believe that our focus on managing risk will allow us to generate strong returns for our investors. Thus, we continue to focus on understanding supply side economics for each commodity, and on identifying those commodities with reasonably steep cost curves. We contend that there are a finite number of advantaged assets for each commodity, and thus we tend to concentrate on the lowest cost projects while remaining broadly diversified across commodities.

Our longer-term outlook for natural resources remains positive. Supply costs for many commodities continue to rise for geological reasons, excess capacity remains relatively low, the longer-term demand trends from emerging market countries remain favorable, and the risk of inflation in basic commodities continues to rise. Our objective in the current environment is to continue to expose our shareholders to the most advantaged natural resource companies across the commodities spectrum when valuations are attractive. By doing so, we believe that we are best able to provide our investors with all the benefits associated with investing in the natural resource space, while also mitigating the associated risks. As long term investors, we feel that these are the types of markets that establish the foundation for strong future returns, and we are excited about the prospects moving forward.


## **Outlook**

We are neither macro economists nor top-down investors. However, we believe that we are in a period of protracted volatility as the markets continue to grapple with a variety of issues, including ongoing deleveraging, deflation/inflation risks, government budget deficits, higher taxes, and the potential for rising risk premiums. While we have become less defensive, we do remain cautious with respect to the levels of financial and operational leverage that we will tolerate within our portfolio companies. We have never attempted to maximize short-term results, as we do not believe that our investors would be adequately compensated for the level of risk that we would have to assume.

With the possibility for increasing interest rates, inflation and taxes conspiring to raise the market discount rate, we believe future performance will no longer benefit from the re-rating of risk. As such, we believe that the Fund is very well positioned for a return to a more fundamentally-driven environment where individual company-specific cashflows are again relevant. We remain long-term investors focused on identifying structural changes that will drive a sustained increase in a company’s return on invested capital. We firmly believe that our long-term investment horizon, the strength of our team and the benefits of our consistent and repeatable process will benefit our investors over the long-term.

We thank you as always for your ongoing support.

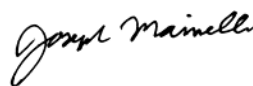
Sincerely,



Mackenzie Davis, CFA  
Co-Portfolio Manager



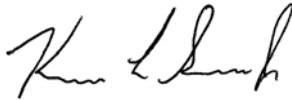
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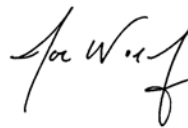
Joseph Mainelli  
Co-Portfolio Manager



Andrew Pilara  
Co-Portfolio Manager



Ken Settles, CFA  
Co-Portfolio Manager



Joe Wolf  
Co-Portfolio Manager

As with all mutual funds, the value of an investment in the Fund could decline, so you could lose money. Investments in companies in natural resources industries may involve risks including changes in commodities prices, changes in demand for various natural resources, changes in energy prices, and international political and economic developments. Investing in small- and mid-size companies can involve risks such as having less publicly available information, higher volatility, and less liquidity than in the case of larger companies. Investing in a more limited number of issuers and sectors can be subject to greater market fluctuation. 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. Foreign securities are subject to political, regulatory, economic, and exchange-rate risks not present in domestic investments. The value of a debt security is affected by changes in interest rates and is subject to any credit risk of the issuer or guarantor of the security.

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, 2010.

***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).***

#### **Appendix—Stock Examples**

**Compass Minerals International, Inc. (CMP)** (2.50% of holdings as of 3/31/10) was a positive contributor to returns during the first quarter. Compass Minerals produces salt, utilized mainly for deicing roads during the winter, and sulfate of potash (SOP), used primarily as a fertilizer for specialty crops. The company is a low cost producer of both salt and SOP due to the advantaged nature of its assets. Specifically, the company's Goderich salt mine in Ontario is one of the largest and lowest-cost salt mines in the world. The mine also benefits from being located on Lake Huron which, given the low value-to-weight ratio for salt, provides Compass with a significant advantage in terms of its cost to deliver salt to its customers in the region. In the SOP business, Compass is a

low-cost producer because it operates solar evaporation ponds at the Great Salt Lake. Most SOP is produced from more expensive chemical processes that convert muriate of potash into SOP.

Our investment in Compass has been premised on the view that the company will be able to generate attractive rates of return by investing in expansions of its low-cost salt mine and solar evaporation ponds. In addition, we believe that Compass will benefit from the continued increase in supply costs for other salt and potash producers with less favorable geology. The rise in industry costs has resulted in an increase in prices for both salt and SOP. In fact, salt prices have grown 3-4% annually for several decades, providing investors with a surprisingly effective hedge against inflation. SOP prices, although quite volatile, have also increased significantly over the past several years. To the extent that Compass can realize higher margins and asset turns as industry costs continue to rise, we believe the company's returns should improve across these unique commodity cycles. Although changes in demand for salt and potash may impact performance over short periods of time, we believe that Compass is well-positioned to show improving returns and strong growth in net asset value over the next several years.

**Euronet Worldwide, Inc. (EFT) (1.70%)** provides electronic payment services across three primary segments: electronic financial transaction (EFT) processing, prepaid processing and money transfer. Euronet underperformed the market over the past six months largely due to the strengthening of the US Dollar vs. the Euro and the Pound. Though headquartered in the United States, Euronet generates approximately 75% of its revenues from non-US operations and underlying business fundamentals remain robust. Despite a challenging economic environment, the company posted strong organic growth in 2009, with revenue and EBITDA growth of 7% and 12%, respectively, excluding currency fluctuations.

Euronet's EFT Processing segment processes transactions for a network of 9,720 ATMs and 53,000 point of sale terminals across Europe, the Middle East and Asia Pacific. Euronet collects a toll for each transaction processed over its network, as well as a monthly fee for managing and servicing ATMs on behalf of its customers. We expect that the developing middle class in Euronet's markets, particularly in high growth areas such as India and China, will lead to increasing ATMs per capita. We believe this should drive the continued growth of this segment for many years to come. With a highly scalable cost structure, we believe that the company has ample room for margin expansion in its EFT Processing segment.

Euronet's Prepaid Processing segment distributes prepaid mobile airtime and other prepaid products across a network of nearly 500,000 POS terminals in Europe, the Middle East, Asia Pacific and North America. We believe Euronet's vast installed base provides it with valuable "real estate" to become a critical gateway for adding additional prepaid services such as iTunes purchases, internet access, gift cards, bill payment and transportation credits. With key competitors in Europe and Australia under distress, we believe the outlook for this division remains robust. Finally, Euronet's Money Transfer business continues to face headwinds from the weakened US to Mexico corridor; however, this segment accounts for only 15% of company earnings. Comparables should begin to ease as we move through 2010 and the company is having success growing its non-US based money transfer business.

In summary, we expect that Euronet will make continued progress during 2010 due to strong core fundamentals across its business segments. Furthermore, we see additional upside that could result from several growth initiatives that the company has been investing in over the past few years.

## Sector Allocation<sup>4</sup>

(As of 3/31/10)

Financial Services	43.76%
Consumer Discretionary	15.84%
Health Care	10.57%
Technology	10.54%
Energy	7.81%
Materials and Processing	2.50%
Utilities	1.84%
Cash	7.14%

## Top Ten Holdings<sup>5</sup>

(As of 3/31/10)

Coinstar, Inc.	3.76%
ACI Worldwide, Inc.	3.65%
Associated Banc-Corp	3.35%
Denbury Resources, Inc.	3.11%
StanCorp Financial Group, Inc.	2.87%
BorgWarner, Inc.	2.73%
Career Education Corp.	2.59%
FEI Co.	2.58%
Compass Minerals International, Inc.	2.50%
First Horizon National Corp.	2.49%

## Performance

(Average Annual Total Returns as of 3/31/10)

	First Quarter 2010	1-Year	3-Year	5-Year	10-Year	Since Inception <sup>6</sup>
RS Partners Fund, Class A						
without sales charge	11.33%	68.56%	-3.23%	3.55%	14.43%	11.96%
with maximum sales charge	6.04%	60.57%	-4.78%	2.55%	13.87%	11.59%
Russell 2000 <sup>®</sup> Value Index <sup>1</sup>	10.02%	65.07%	-5.71%	2.75%	8.90%	9.66%

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

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<sup>1</sup> The Russell 2000<sup>®</sup> Value Index is an unmanaged market-capitalization-weighted index that measures the performance of those companies in the Russell 2000<sup>®</sup> Index with lower price-to-book ratios and lower forecasted growth values. (The Russell 2000 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.

<sup>2</sup> Source: FactSet and Bernstein Research analysis, Equity Portfolio Strategy Materials, January 7, 2010. Bernstein's quality model, which includes six factors including ROE, sales growth, net margin and three stability metrics, determined average annualized relative returns of -15.0% for the highest quality quintile vs. +36.0% for the lowest quality quintile for the period from March 2009 to December 2009.

<sup>3</sup> Source: BofA Merrill Lynch Small Cap Performance Monitor, April 1, 2010. This report shows that the lowest quintile ROE names in the Russell 2000 Value Index were up 12.82% in the first quarter compared to 8.93% for the highest quintile ROE stocks. In addition, nonearners gained 14.30% during the first quarter, exceeding the benchmark return by 429 basis points.

**4** The sector allocation represents the Global Industry Classification Standard (GICS), which was developed by Morgan Stanley Capital International (MSCI) and Standard & Poor's (S&P). The Fund's holdings are allocated to each sector based on their GICS classification. Cash includes short-term investments and net other assets and liabilities.

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

**6** Class A shares inception date July 12, 1995.

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