RS|investments

Third Quarter 2009 Mutual Fund Commentary
RS Value Fund

Performance and Market Commentary

RS Value Fund (Class A Shares) returned 20.05% versus 23.62% for the Russell Midcap® Value Index[1] during the third quarter period ended September 30, 2009. Calendar year-to-date, the Fund outperformed its benchmark by more than 700 basis points, posting a 34.62% increase versus 27.57% for the benchmark. A broad-based market rally drove performance during the period as prospects for recovery brightened and investors bid up shares in anticipation of improving economic results. The Fund largely kept pace with broad market improvements and all sectors that we had exposure to contributed positively to Fund performance.

The third quarter witnessed a continuation of the “risk trade” that has been in place since the market bottomed in March of this year. Since that time, the best-performing stocks, across all capitalization ranges, have generally been the lowest return on equity companies, many with no earnings or cash flow. Long-time readers shouldn’t be surprised that we have never positioned our shareholders’ capital to maximize returns in this type of environment, as we view this as a “trade” rather than an investment. Instead, we have allocated capital to fundamentally strong businesses and management teams where we can quantify the magnitude of improvement in returns over our investment time frame. We are pleased to report that, in general, our companies are executing according to plan.

That said, despite the fact that the Fund experienced appreciation across all of its sectors during the quarter, our companies simply didn’t appreciate to the same degree as did the more speculative investments within the index. With the powerful “risk trade” propelling the market higher during the third quarter, several of the high quality franchises in our portfolio underperformed the market. Examples include Career Education Corp. (4.03% of holdings as of 9/30/09) and Calpine Corp. (1.92%), which remain among our to performing investments for the year.

It is important to note that our solid absolute and relative performance for the year is primarily a function of how our investments behaved during the challenging first quarter of the year. Investment results are a function of past decisions and we believe that our year-to-date performance is the direct result of the sound decisions our team made in the teeth of the 2008 financial crisis. These solid results underscore the merits of our long-term investment horizon, the strength of our team, and the benefits of our consistent and repeatable process, which is focused on downside protection. Importantly, over the nearly 8 years since the RS Value Team took over management of the Fund, starting January 1, 2002, the Fund has posted annualized returns of 11.36%, versus 6.38% for the benchmark Russell Midcap Value Index and 0.88% for the S&P 500® Index[2]. In markets as volatile as these, we believe that risk management starts with trying to understand our companies as well as anyone in the market, and then deploying capital when the price available in the market is equal to the valuation generated by our downside case. As we always remind each other, "it's not what you make, it's what you keep."

Team Update

Our most successful investments have occurred when we find a company that is able to reinvest organically into high return projects. Over the years, we have applied a similar approach/philosophy to our own business by aggressively reinvesting in our most valuable resource – our people. While many firms in our industry have been forced to retrench through the downturn, we are pleased to announce that Daniel Lang, MD, and Randy Sternke, CFA, joined the RS Value Team during the third quarter.

Daniel Lang, MD, a former cardiologist, will focus on the healthcare sector. Dan spent the past 15 years practicing medicine, building and managing healthcare businesses, and ultimately overseeing a large cap healthcare portfolio for Farallon Capital Management, one of the largest hedge fund managers in the United States. In his medical career, he was a fellow in cardiology at the University of California, San Francisco, and chief medical resident at Mount Sinai Hospital in New York. Dan received a medical degree from Cornell University Medical College after earning his bachelor's degree in chemistry from Cornell, with distinction in all subjects.

Randy Sternke, CFA, joins the RS Value Team after serving as an investment analyst specializing in financial services at Merrill Lynch in San Francisco. Prior to this he was an analyst with A.G. Edwards & Sons, covering banking and media and entertainment. Randy holds a bachelor's degree in business administration, with a concentration in finance and banking from the University of Missouri-Columbia. He is also a member of the San Francisco CFA Society.

We are delighted to welcome Dan and Randy to our team. The hiring of additional research talent reflects our commitment to reinvest in our business and strengthen our already deep investment team. These recent personnel additions were not made to fill a specific void, but rather to enhance our existing coverage universe by bringing additional expertise to our group. Our investment approach and business model are designed such that each investment professional is responsible for just one new investment idea every three to four months. As such, we are able to encourage team members to be extraordinarily thorough in their due diligence and give them the time and resources to be very knowledgable investors in the market. We are firm believers that, in the final analysis, knowledge is the best risk mitigant.

Outlook

The Fund's portfolio positioning and performance are consistent with our more balanced view regarding the current economic outlook and our comparatively muted appetite for risk. We believe that we can continue to buy high quality companies at very attractive valuations that possess the requisite asymmetric risk profile.

We are no longer in an environment where we can purchase the very best companies and management teams using our draconian downside estimate of asset value. That unique opportunity came to an end when it became apparent late in the first quarter that the binary option of "going to zero" was no longer a high probability event. Having said that, we believe that quality remains "cheap," as we continue to find companies with high recurring revenue streams, solid and defensible business models, clean balance sheets, and strong management teams available at discounts to their more highly leveraged peers. We will continue to take advantage of these opportunities as we find them.

Our core philosophy and process have withstood the test of time and we continue to adhere to the same basic tenets:

1. We are business analysts focused on returns-based investing. We seek to identify structural changes that will drive a sustainable increase in a company's return on invested capital over our three-five year investment time frame.
2. Sector allocations are driven by bottom-up, grass roots research and ultimately reflect our conviction in individual companies.
3. Our 15 investment professionals seek to know our businesses as well as anyone in the market.
4. We engage in team-oriented investing by having at least two professionals dedicated to each potential recipient of our capital. We believe this leads to more thorough analysis and a more objective identification of potential risks.
5. We believe that investment returns are a function of entry price.
6. We focus on downside protection as a means to optimize risk-adjusted returns.

The investment results are and will continue to be entirely a function of our ability to apply this process and philosophy. We continue to run a diversified portfolio that has historically derived the majority of its alpha from stock selection. We remain long-term investors and are confident that our team and process will continue to protect and grow your capital over time.

As always, we thank you for your ongoing support.

Sincerely,

MacKenzie Davis, CFA
Co-Portfolio Manager

David Kelley
Co-Portfolio Manager

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. 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. 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.

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, 2009.

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.

Appendix—Stock Examples

Agilent Technologies Inc. (3.87%) provides test and measurement solutions to a broad array of end markets. The company was spun out of HP in 1999 and since then has undergone a significant transformation, restructuring its legacy electronics and semiconductor business units while allocating more capital to its Bio-Analytical (BAM) segment. BAM is Agilent's highest quality business generating 20% after-tax returns and is characterized by long product cycles and limited competition. New products should improve pricing power and result in further improvement in returns on capital. As a result, we expect BAM to account for well over half of Agilent's cash flow over the next several years. The Electronic Measurement (EM) business has also been rationalized. By reorienting EM toward more R&D applications and shrinking semiconductor, capital intensity should decrease while margins improve.

The initial opportunity to invest was a function of two concerns in the market: (1) the impact of pharma consolidation on overall research and development budgets, which would reduce capital available for equipment purchases, and (2) the challenging outlook for the more cyclical Electronic Measurement (EM) business unit. After considerable work analyzing Agilent's product positioning and dissecting aggregate R&D budgets, we were comfortable that even under a draconian scenario, the downside risk to BAM's cash flow was negligible. In addition, we did not believe that the price we paid in the market reflected any value for the EM business. As a result, we established our initial position in the company with the expectation that we had a reasonable margin of error to protect us from a short-term outlook that remains challenging. In March of this year, management proactively re-sized the EM business, allowing the business to generate attractive returns at a 30% lower revenue run-rate. While the stock traded up on this announcement, we deployed more capital into Agilent as our main downside risk – the inability of EM to generate reasonable free cashflow – had been addressed.

As value investors we prefer to buy attractive businesses at ever cheaper prices; however, when the risk dynamic changes, so too must our investment decisions. In July, Agilent purchased a smaller competitor, Varian. We believe this acquisition will achieve a return well above Agilent's cost of capital within a reasonable time period, given the target's strong life science franchise and the unique vertical integration opportunities presented by the business combination. Agilent remains a core holding and we are enthusiastic about the long-term outlook for our investment in the company.

Scientific Games (3.10%) is a Company that we have owned for several years, and it possesses the type of business fundamentals that we would hope to own for years to come. Scientific Games is a developer, designer, and manufacturer of instant lottery tickets and other gaming operations for states and foreign countries. Due to its scale and intellectual property, the Company has a near monopoly in the highly-profitable scratch-off instant ticket lottery business, generates exceptionally high ROICs, has long term contracts with high renewal rates, and will benefit from numerous international growth initiatives that are currently underway. Despite these compelling business fundamentals, the stock price has declined this year on concerns related to the Italian government putting the renewal of its country's lottery out for bid. We think that these concerns are overblown and that it is unlikely that the Italian contract will be awarded to a competitor, especially in light of the fact that over the years Scientific Games has been instrumental in taking over the previously nascent Italian lottery and turning it into the most successful instant lottery in the world. The more likely outcome is that Scientific Games may need to give up some of its margin in order to retain the Italian contract.

More importantly, the potential margin hit (or even the outright loss) associated with the Italian contract will be overwhelmed by several other initiatives currently underway at the Company. Under the leadership and direction of new CEO Joe Wright and CFO Jeff Lipkin, tremendous opportunities exist for Scientific Games to optimize its assets and returns by expanding margins, reducing capex, repaying debt, and harnessing the company's international growth opportunities. For example, after an intense study of the Company's procurement costs, management has identified over $50 million in annual cost saves.

Moreover, the Company should be a beneficiary as states and governments look to fill budgetary gaps, while capitalizing on its huge growth opportunity as the designated developer of instant lottery tickets for the Chinese government. The Chinese lottery opportunity alone has the potential to single-handedly increase the cash flow of the Company by nearly 75% over the next three to five years. Additionally, there are a number of other significant growth drivers that we believe will materially increase the value of the Company (e.g., instant ticket launches in the German lotteries, expansion of the UK pub slot business, privatization of US lotteries, sports gaming business). We believe that the future looks extremely promising for this Company, with the potential for investors to earn multiples of capital over the next five years. As a result, we increased our position in Scientific Games during the third quarter of 2009.

Sector Allocation[3]
(As of 9/30/09)

Financial Services	34.16%
Consumer Discretionary	16.78%
Producer Durables	9.66%
Materials & Processing	9.40%
Energy	8.26%
Health Care	6.58%
Technology	6.21%
Utilities	1.89%
Cash	7.05%

Top Ten Holdings[4]
(As of 9/30/09)

Career Education Corp.	4.03%
Agilent Technologies, Inc.	3.87%
Biovail Corp.	3.81%
Comverse Technology, Inc.	3.60%
Ameriprise Financial, Inc.	3.50%
Martin Marietta Materials, Inc.	3.14%
Scientific Games Corp.	3.10%
KKR Private Equity Investors	3.09%
Talisman Energy, Inc.	2.96%
Covidien PLC	2.88%

Performance
(Average Annual Total Returns as of 9/30/09)

	Third Quarter 2009	1-Year	3-Year	5-Year	10-Year	Since Inception[5]
RS Value Fund, Class A						
without sales charge	20.05%	-1.12%	-4.03%	4.43%	9.24%	5.99%
with maximum sales charge	14.33%	-5.82%	-5.57%	3.41%	8.71%	5.67%
Russell Midcap® Value Index[1]	23.62%	-7.12%	-5.65%	3.53%	7.43%	9.83%

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 1.41%. 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.

1 The Russell Midcap® Value Index is an unmanaged market-capitalization-weighted index that measures the performance of those companies in the Russell Midcap Index with lower price-to-book ratios and lower forecasted growth values. (The Russell Midcap® Index measures the performance of the 800 smallest companies in the Russell 1000® Index, which consists of the 1,000 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, the index does not incur fees or expenses.
2 The S&P 500® Index is an unmanaged market capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. 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, the index 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 June 30, 1993.