

Fall 2011

The Royce Funds  
Shareholder Newsletter

# RWord

## Be Patient and Take the Long View

*Chuck Royce on Third Quarter 2011*

1

**Is the U.S. in a crisis right now? If so, what kind of a crisis is it?**

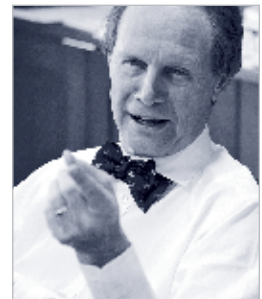
I do not think we're in a financial crisis currently, but I would describe what's happening as more of an existential crisis—a crisis of leadership and political will that has drained people's confidence in our ability to make the necessary changes that would improve our economy. We are painfully aware of politicians' unwillingness to transcend partisan differences for the good of the country during a time of acute economic anxiety, which has the effect of increasing that anxiety. In fact, I suspect that the bear market has been driven not so much by the situation in Greece as by the idea that both political parties are hostages to special interests and to the most extreme ideological fringes. However, I am confident that we will ultimately meet our challenges politically and economically. As for the stock market, I think that the current mood is so unrelentingly negative that even a small-scale positive surprise could shift the mindset of investors to a positive perspective.

2

**What is most important for investors to know in these challenging times?**

I would say that investors first and foremost need to be patient and take the long view. Of course, this is a perennial attitude for our investment staff here at Royce, but in highly challenging times like these it's even more important to stick to our core investment principles. I understand that looking ahead three to five years is not easy, especially after the Lost Decade for many investors between 2000 and 2009. Life has been difficult through much of the last dozen years. However, I would remind people who remain worried about when and where to invest that most U.S. companies made their way through the financial crisis very effectively, and their current financial condition is very strong. We are seeing a large number of well-managed businesses expanding their global presence, which in our view makes them well-positioned to succeed when the global economy begins to grow more quickly. These are the kinds of companies that we're buying as we look at the long term.

*continued on next page*



**Chuck Royce** President and  
Co-Chief Investment Officer,  
*The Royce Funds*

*At Royce we are dedicated to providing investors with the best available smaller-cap mutual funds, both international and domestic.*

**The Royce Funds**

COMMITTED TO SMALLER COMPANIES, DEVOTED TO VALUE

The downturn has created significant opportunities in companies that look attractively discounted and that we think could appreciate significantly over the long run.

*continued from cover*

3

**The small-cap Russell 2000 Index fell 25.2% from its 2011 high on April 29 through its low on September 22. What do you think are some of the implications of this sharp decline for small-cap investors going forward?**

For us, it has yielded a number of very promising opportunities throughout the smaller-company space. The selling has been totally indiscriminate, which has allowed us to find what we think are terrific bargains in great businesses in all sectors and industries. Our goal when we buy a stock is to double our money in three to five years. Part of trying to realize that objective is to pay a price well below what we think a stock is worth. The downturn has created significant opportunities in companies that look attractively discounted and that we think could appreciate significantly over the long run.

4

**Why is active small-cap management so important in the current environment?**

To us, active management is synonymous with risk management. We believe that any edge we may provide is rooted in our ability to apply the tools of risk management—they are an integral part of our stock selection process. In the current market, which is teeming with cheap stocks whose low prices are very tempting, our focus on risk makes us discerning buyers. We never buy stocks just because they are cheap. We buy because we see what we think are well-run companies trading at attractive prices, businesses that possess the financial strength to overcome what is hopefully short-term adversity. Strong balance sheets, high returns on invested capital and the ability to generate free cash flow are the kind of traits that give us some assurance that stocks whose shares have been falling have what it takes to bounce back. We have always thought that, sooner or later, high-quality companies should flourish. Our relentless search for quality helps to set us apart and, I think, gives active small-cap managers like us a long-term advantage.

5

**With all we hear about the advantages of developing economies versus developed ones, how do you see the long-term prospects for U.S. companies?**

I think the long-term prospects for the best-managed U.S. companies are very bright. Over the last several years, we've seen the smartest companies, including many in the small-cap world, make the most of opportunities in the global economy. We've also seen many U.S. firms manage their businesses very intelligently during difficult years, so we feel very positively about their prospects.



# The Royce Funds' Performance and Expenses

Unlike a lot of mutual fund groups with broad product offerings, we have chosen to concentrate on smaller-company investing by providing investors with a range of funds that take full advantage of this large and diverse sector.

## PERFORMANCE AND EXPENSES Through September 30, 2011

CATEGORY Fund	Average Annual Total Returns						Annual Expenses	
	Third Quarter 2011 <sup>1</sup>	One- Year	Five- Year	10- Year	Since Inception	Inception Date	Gross Operating Expenses	Net Operating Expenses
<b>CORE</b>								
Royce Pennsylvania Mutual Fund	-21.07%	-2.79%	0.77%	8.38%	n.a.	n.a.	0.90%	0.90%
Royce Heritage Fund	-23.00	-5.89	1.64	8.41	12.68%	12/27/95	1.51	1.51
<b>CORE + DIVIDENDS</b>								
Royce Total Return Fund	-16.98	-2.07	0.60	7.51	9.95	12/15/93	1.17	1.17
Royce Dividend Value Fund	-19.42	-4.39	2.01	n.a.	5.67	5/3/04	1.58	1.51
<b>FOCUSED</b>								
Royce Premier Fund <sup>2</sup>	-18.77	2.27	5.02	11.10	11.54	12/31/91	1.12	1.12
Royce Special Equity Fund	-14.73	0.30	3.83	10.03	7.84	5/1/98	1.16	1.16
Royce Value Fund	-21.97	-3.07	2.80	11.35	9.64	6/14/01	1.46	1.46
Royce 100 Fund	-23.54	-6.71	2.63	n.a.	8.36	6/30/03	1.50	1.49
<b>OPPORTUNISTIC THEMES</b>								
Royce Low-Priced Stock Fund <sup>2</sup>	-23.33	-5.25	2.79	9.11	11.70	12/15/93	1.64	1.53
Royce Opportunity Fund	-28.01	-11.94	-1.60	8.04	10.54	11/19/96	1.18	1.18
Royce Value Plus Fund	-22.41	-7.35	-1.68	11.25	10.06	6/14/01	1.44	1.44
<b>MICRO-CAP</b>								
Royce Micro-Cap Fund <sup>2</sup>	-22.12	-6.11	2.78	9.97	12.14	12/31/91	1.54	1.54
Royce Discovery Fund	-15.80	-0.44	-2.54	n.a.	3.04	10/3/03	3.04	1.49
<b>MID-CAP</b>								
Royce SMid-Cap Value Fund	-22.60	-6.83	n.a.	n.a.	-1.74	9/28/07	2.40	1.49
Royce Mid-Cap Fund	-20.65	-3.74	n.a.	n.a.	0.17	12/31/09	2.64	1.49
<b>GLOBAL/INTERNATIONAL</b>								
Royce Global Value Fund	-22.02	-5.01	n.a.	n.a.	4.30	12/29/06	1.93	1.78
Royce International Smaller-Companies Fund	-21.43	-8.66	n.a.	n.a.	2.41	6/30/08	2.40	1.74
Royce European Smaller-Companies Fund	-24.23	-10.11	n.a.	n.a.	-1.50	12/29/06	2.67	1.79
<b>QUALIFIED INVESTOR</b>								
Royce Select Fund I	-21.54	-4.90	4.06	10.58	12.42	11/18/98	2.38	2.38
Royce Select Fund II	-22.34	-14.60	0.23	n.a.	3.24	6/30/05	2.80	2.80
Royce Global Select Fund	-19.89	-6.68	8.14	n.a.	10.37	6/30/05	3.53	3.53
Royce SMid-Cap Select Fund	-17.49	-2.40	n.a.	n.a.	-1.32	9/28/07	0.71	0.71
Russell 2000 Index	<b>-21.87</b>	<b>-3.53</b>	<b>-1.02</b>	<b>6.12</b>	<b>n.a.</b>	<b>n.a.</b>	<b>n.a.</b>	<b>n.a.</b>

Royce Pennsylvania Mutual Fund's average annual total return for the 35-year period ended 9/30/11 was 13.34%.

<sup>1</sup> Not annualized

<sup>2</sup> This Fund is only open to existing investors and existing relationships.

### Important Performance and Expense Information

All performance information in this newsletter reflects past performance, is presented on a total return basis, reflects the reinvestment of distributions and does not reflect the deduction of taxes that a shareholder would pay on fund distributions or the redemption of fund shares. Past performance is no guarantee of future results. Investment return and principal value of an investment will fluctuate, so that shares may be worth more or less than their original cost when redeemed. Shares redeemed within 180 days (365 days for Royce's Qualified Investor Funds) of purchase may be subject to a 1% redemption fee payable to the Fund (2% for Royce Qualified Investor Funds, and Royce Global Value, International Smaller-Companies and European Smaller-Companies Funds). Redemption fees are not reflected in the performance shown above; if they were, performance would be lower. Current performance may be higher or lower than performance quoted. Current month-end performance information may be obtained at [www.roycefunds.com](http://www.roycefunds.com). All performance and expense information reflects results of the Fund's oldest share Class (Investment Class or Service Class, as the case may be). Gross operating expenses reflect each Fund's gross total annual operating expenses, including management fees, any 12b-1 distribution and service fees, other expenses, and any applicable acquired fund fees and expenses. Net operating expenses reflect contractual fee waivers and/or expense reimbursements. All expense information is reported as of the Fund's most current prospectus. Royce & Associates has contractually agreed to waive fees and/or reimburse operating expenses through April 30, 2012 (April 30, 2013 for Royce Mid-Cap Fund) to the extent necessary to maintain net annual operating expenses, other than acquired fund fees and expenses, to no more than 1.49% for the Service Class of Royce Dividend Value, 100, Low-Priced Stock, Discovery, SMid-Cap Value and Mid-Cap Funds, and to no more than 1.69% for the Service Class of Royce Global Value, International Smaller-Companies and European Smaller-Companies Funds. Royce & Associates has contractually agreed to waive fees and/or reimburse operating expenses through April 30, 2021 to the extent necessary to maintain net annual operating expenses, other than acquired fund fees and expenses, to no more than 1.99% for the Service Class of Royce Discovery, SMid-Cap Value, Mid-Cap, International Smaller-Companies and European Smaller-Companies Funds. For Qualified Investor Funds, annual operating expenses reflect each Fund's total annual operating expenses as of the most current prospectus and include management fees based on 12.5% of their pre-fee, high-watermark total returns in 2010, (+19.0% for Royce Select Fund I, +19.8% for Royce Select Fund II, +27.2% for Royce Global Select Fund and +5.6% for Royce SMid-Cap Select Fund). Each Qualified Investor Fund's respective total annual Fund operating expense ratio was 2.38%, 2.80%, 3.53% and 0.71%. For Royce Select Fund I and Royce SMid-Cap Select Fund, this also included acquired fund fees and expenses. For Royce Select Fund II and Royce Global Select Fund, it included dividends on securities sold short, acquired fund fees and expenses and interest expense on borrowings. Actual management fees will depend on each Fund's future returns. Royce & Associates has contractually agreed to absorb all other operating expenses of each Qualified Investor Fund, other than dividend expense relating to any short selling activity, acquired fund fees and expenses and interest expense on borrowings, when applicable. Acquired fund fees and expenses reflect the estimated amount of the fees and expenses incurred indirectly by the Fund through its investments in mutual funds, hedge funds, private equity funds and other investment companies.

Shares of a Fund's Service, Consultant, R and K Classes bear an annual distribution expense that is not borne by the Fund's Investment Class. The Royce Funds invest primarily in securities of micro-cap, small-cap and/or mid-cap companies, which may involve considerably more risk than investments in securities of larger-cap companies (see "Primary Risks for Fund Investors" in the respective Prospectus). Please read the Prospectus carefully before investing or sending money. Russell Investment Group is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Russell Investment Group. The Russell 2000 is an unmanaged, capitalization-weighted index of domestic small-cap stocks that measures the performance of the 2,000 smallest publicly traded U.S. companies in the Russell 3000 Index.

# Charlie Dreifus Takes on Large-Caps



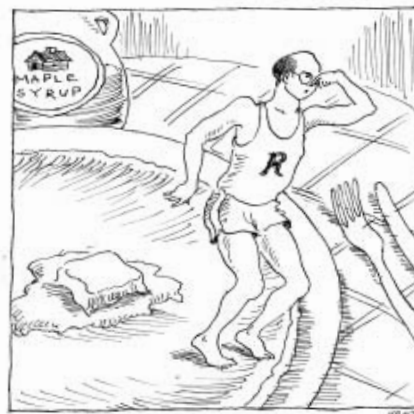
Charlie Dreifus, manager of **Royce Special Equity Fund (RSEFX)** launched a new fund, **Royce Special Equity Multi-Cap Fund (RSEMXX)**, on December 31, 2010. Like the original Fund, it seeks long-term growth of capital by using an intensive value approach that combines classic value analysis, the identification of good businesses and accounting cynicism. In our current

low-interest rate environment, Charlie believes this fund's attention to dividends will also prove rewarding. Where it differs is in the market capitalization of the companies in which it invests: a significant portion of its assets will be invested in mid-cap and large-cap companies with market capitalizations of more than \$5 billion.

"In my opinion, the large-cap asset class has looked cheap for a long time," says Dreifus. "I started investing in the space personally during the crisis of 2008-2009 and believe that over the next 10 years, there will likely be rotation in leadership from small-cap to large-cap." Rate of return is a function of entry price, and recent prices in large-caps are very attractive as many are underappreciated. This is not to say that I don't still believe we can find attractive small-cap companies that can provide good returns. In fact, to the contrary, the current environment is ripe for increased merger and acquisition and other transactional activity that can bode well for small-caps and can drive them to potentially outperform over the next one to two years.

Dreifus applies the same methodology and metrics to both Funds. "I still look for high, sustainable returns on invested capital and strong levels of free cash flow from operations, among other attributes. I'm still going to buy companies on an absolute basis and it won't be uncommon to see many household, 'dividend aristocrat' type names." He scours the financial statements of the companies he's considering for investment. "The financials become a mosaic of the company for me. I read them from back to front starting with the footnotes. They help me to gain an understanding of the company's culture that will either support my belief in whether earnings will persist into the future or not. I've been doing this for more than 40 years and this practice allows me to hear what the financial statements of a company are saying."

Dreifus believes that the next decade will parallel the early 1970s in that in those years there was a group of companies coined the "Nifty Fifty," blue-chip, large-cap American stocks with strong earnings growth that outperformed the broader market during the early part of that decade. "Today and for the unforeseeable future, with interest rates low, there is a need for a bond surrogate. The aging population is and will be searching for stability and income and there are very few alternatives. I suggest that the Nifty Fifty of the next generation will be a portfolio of companies who have the capacity to, and have had a history of, increasing dividends." These companies are high quality with stable earnings and cash flow such that they have the capacity to pay and grow dividends over time.



---

► This article is excerpted from a recent interview with Charlie Dreifus. To read the interview, visit [www.roycefunds.com/MultiCap](http://www.roycefunds.com/MultiCap).

---

Regardless of market cap, when it comes to stock selection and portfolio construction, Charlie's cautious approach to risk is akin to that of jumping off of a pancake, by no means an extreme sport.

## FOLLOW ROYCE ON TWITTER AND RSS.

Now it's easier than ever to get the latest from *The Royce Funds*. Subscribe to our RSS feed or follow us on Twitter at:

 [www.roycefunds.com/rss](http://www.roycefunds.com/rss)

 [www.twitter.com/RoyceFunds](https://twitter.com/RoyceFunds)

The thoughts expressed here are solely those of Mr. Dreifus, and may differ from those of other Royce investment professionals, or the firm as a whole. There can be no assurance with regard to future market movements. **This material is not authorized for distribution unless preceded or accompanied by a current prospectus. Please read the prospectus carefully before investing or sending money.** Royce Special Equity Fund invests primarily in small-cap and micro-cap stocks, which may involve considerably more risk than investing in larger-cap stocks (Please see "Primary Risks for Fund Investors" in the prospectus). Royce Special Equity Multi-Cap Fund invests primarily in the equity securities of mid- and larger-cap companies with market capitalizations of more than \$5 billion.

As of 9/30/11, both Funds held a limited number of stocks, which may involve considerably more risk than a less concentrated portfolio because a decline in the value of these stocks would cause the Fund's overall value to decline to a greater degree.

# Co-CIO Whitney George Celebrates 20 Years at Royce



Royce's Co-CIO Whitney George has been called the "King of Small Caps" by Dyan Machan and has made the cover of *SmartMoney* magazine as a "Fund Manager of the Year," but to us—and we're admittedly biased—he's one of the most talented portfolio managers around. There is no question that Whitney has made his mark in smaller company investing and at *The Royce Funds*.

Please join us in celebrating Whitney's 20th anniversary with Royce and more than 30 years in the industry. Whitney was named co-Chief Investment Officer in 2009 and one of his primary roles is to help train new portfolio managers in all things Royce. He also ensures that the portfolio management team maintains the investment discipline first cultivated by Chuck Royce in the early '70s.

When he joined the firm in 1991, Royce & Associates had one large mutual fund and just a handful of employees. While working alongside Chuck, Whitney helped to develop a new way of looking at the small-cap market at Royce, primarily by dividing the overall small-cap market into micro-cap and small-caps.

Over the years, we have added funds and grown a great deal as a firm. We've intensified our global investment efforts by launching funds that invest primarily in stocks all around the world or in non-U.S. equities and also introduced funds that migrated into the mid-cap space. In all of these activities, Chuck Royce has described Whitney as "a leader who continues to be a major force in the growth and success of the firm, as he has been over the last two decades."

**"Whitney is a leader who continues to be a major force in the growth and success of the firm, as he has been over the last two decades."** – Chuck Royce

## Funds Managed by Whitney George

Portfolio Manger or Co-Portfolio Manager		Assistant Portfolio Manager
Royce Premier Fund	Royce SMid-Cap Value Fund	Royce Micro-Cap Fund
Royce Low-Priced Stock Fund	Royce Focus Value Fund	Royce Value Plus Fund
Royce Value Fund	Royce Mid-Cap Fund	Royce Global Select Fund
Royce Global Value Fund	Royce Focus Trust	Royce Capital Fund—Micro-Cap Portfolio

► To read more about Whitney George, visit [www.roycefunds.com/Whitney](http://www.roycefunds.com/Whitney).

## IN THE SPOTLIGHT WHAT ALWAYS MATTERS AND WHAT MATTERS NOW: How Royce Is Dealing with Uncertain Political Leadership, a Difficult Economy and a Volatile Market.

Watch Royce Co-CIOs delve into the heart of the issues causing the market turmoil and explain why we think this is more of a confidence crisis than a financial crisis.

► Visit [www.roycefunds.com/CIO](http://www.roycefunds.com/CIO) to view this interview.



## SHOULD YOU MAKE A 2011 IRA CONTRIBUTION?

While day-to-day current expenses may feel more pressing at the moment, to retire comfortably you must make retirement saving a top priority. An Individual Retirement Account, an "IRA", is designed to offer you tax advantages as you invest for retirement. As year-end approaches, consider whether it makes sense to make a 2011 IRA contribution. It may make sense to discuss it with your financial advisor and a tax professional. And if you haven't decided by New Year's Eve, don't panic: you have until April 15, 2012 to make your 2011 contribution.

► For more details on IRAs and Roth IRAs, visit us at [www.roycefunds.com/IRA](http://www.roycefunds.com/IRA).

## eWord

### SIGN UP FOR OUR MONTHLY EMAIL NEWSLETTER

Written for all audiences, the *eWord* will keep you up to date on news and commentary, fund performance, distributions, new offerings and more. Sign up today at [www.roycefunds.com](http://www.roycefunds.com).

This newsletter is not authorized for distribution unless preceded or accompanied by a current prospectus. Please read the prospectus carefully before investing or sending money. Royce & Associates is a registered trademark. The Royce Funds is a service mark of Royce. Distributor: Royce Fund Services, Inc.

## To Our Shareholders

This newsletter provides you with timely and insightful information about *The Royce Funds* and how we manage your money. Here's what's inside:

- Be Patient and Take the Long View, *Chuck Royce on Third Quarter 2011*
- Co-CIO Whitney George Celebrates 20 Years at Royce
- Charlie Dreifus Takes on Large-Caps
- Should You Make a 2011 IRA Contribution?
- Fund Performance Update

**Here's How To Reach Us:**

- [www.roycefunds.com](http://www.roycefunds.com)
- (800) 221-4268

**24-Hour Account Access:**

- [www.roycefunds.com](http://www.roycefunds.com)
- Royce Infoline (800) 78-ROYCE (787-6923)

**Account Information and Telephone Transactions:** (800) 841-1180

# RWORD

The Royce Funds  
Shareholder Newsletter  
**Fall 2011**

745 Fifth Avenue | New York, NY 10151

# TheRoyceFunds

COMMITTED TO SMALLER COMPANIES. DEVOTED TO VALUE

GO  
PAPERLESS

Sign up for e-Delivery at  
[www.roycefunds.com/edelivery](http://www.roycefunds.com/edelivery)



50% post  
consumer waste

The downturn has created significant opportunities in companies that look attractively discounted and that we think could appreciate significantly over the long run.

*continued from cover*

3

**The small-cap Russell 2000 Index fell 25.2% from its 2011 high on April 29 through its low on September 22. What do you think are some of the implications of this sharp decline for small-cap investors going forward?**

For us, it has yielded a number of very promising opportunities throughout the smaller-company space. The selling has been totally indiscriminate, which has allowed us to find what we think are terrific bargains in great businesses in all sectors and industries. Our goal when we buy a stock is to double our money in three to five years. Part of trying to realize that objective is to pay a price well below what we think a stock is worth. The downturn has created significant opportunities in companies that look attractively discounted and that we think could appreciate significantly over the long run.

4

**Why is active small-cap management so important in the current environment?**

To us, active management is synonymous with risk management. We believe that any edge we may provide is rooted in our ability to apply the tools of risk management—they are an integral part of our stock selection process. In the current market, which is teeming with cheap stocks whose low prices are very tempting, our focus on risk makes us discerning buyers. We never buy stocks just because they are cheap. We buy because we see what we think are well-run companies trading at attractive prices, businesses that possess the financial strength to overcome what is hopefully short-term adversity. Strong balance sheets, high returns on invested capital and the ability to generate free cash flow are the kind of traits that give us some assurance that stocks whose shares have been falling have what it takes to bounce back. We have always thought that, sooner or later, high-quality companies should flourish. Our relentless search for quality helps to set us apart and, I think, gives active small-cap managers like us a long-term advantage.

5

**With all we hear about the advantages of developing economies versus developed ones, how do you see the long-term prospects for U.S. companies?**

I think the long-term prospects for the best-managed U.S. companies are very bright. Over the last several years, we've seen the smartest companies, including many in the small-cap world, make the most of opportunities in the global economy. We've also seen many U.S. firms manage their businesses very intelligently during difficult years, so we feel very positively about their prospects.



Mr. Royce's thoughts in this interview concerning the stock market are solely his own and, of course, there can be no assurance with regard to future market movements.

## The Royce Funds' Performance and Expenses

Unlike a lot of mutual fund groups with broad product offerings, we have chosen to concentrate on smaller-company investing by providing investors with a range of funds that take full advantage of this large and diverse sector.

CATEGORY Fund	PERFORMANCE AND EXPENSES Through September 30, 2011						Gross Operating Expenses	Net Operating Expenses
	Third Quarter 2011 <sup>1</sup>	One-Year	Five-Year	10-Year	Since Inception	Inception Date		
<b>CORE</b>								
Royce Pennsylvania Mutual Fund	-21.07%	-2.79%	0.77%	8.38%	n.a.	n.a.	0.90%	0.90%
Royce Heritage Fund	-23.00	-5.89	1.64	8.41	12.68%	12/27/95	1.51	1.51
<b>CORE + DIVIDENDS</b>								
Royce Total Return Fund	-16.98	-2.07	0.60	7.51	9.95	12/15/93	1.17	1.17
Royce Dividend Value Fund	-19.42	-4.39	2.01	n.a.	5.67	5/3/04	1.58	1.51
<b>FOCUSED</b>								
Royce Premier Fund <sup>2</sup>	-18.77	2.27	5.02	11.10	11.54	12/31/91	1.12	1.12
Royce Special Equity Fund	-14.73	0.30	3.83	10.03	7.84	5/1/98	1.16	1.16
Royce Value Fund	-21.97	-3.07	2.80	11.35	9.64	6/14/01	1.46	1.46
Royce 100 Fund	-23.54	-6.71	2.63	n.a.	8.36	6/30/03	1.50	1.49
<b>OPPORTUNISTIC THEMES</b>								
Royce Low-Priced Stock Fund <sup>2</sup>	-23.33	-5.25	2.79	9.11	11.70	12/15/93	1.64	1.53
Royce Opportunity Fund	-28.01	-11.94	-1.60	8.04	10.54	11/19/96	1.18	1.18
Royce Value Plus Fund	-22.41	-7.35	-1.68	11.25	10.06	6/14/01	1.44	1.44
<b>MICRO-CAP</b>								
Royce Micro-Cap Fund <sup>2</sup>	-22.12	-6.11	2.78	9.97	12.14	12/31/91	1.54	1.54
Royce Discovery Fund	-15.80	-0.44	-2.54	n.a.	3.04	10/3/03	3.04	1.49
<b>MID-CAP</b>								
Royce SMid-Cap Value Fund	-22.60	-6.83	n.a.	n.a.	-1.74	9/28/07	2.40	1.49
Royce Mid-Cap Fund	-20.65	-3.74	n.a.	n.a.	0.17	12/31/09	2.64	1.49
<b>GLOBAL/INTERNATIONAL</b>								
Royce Global Value Fund	-22.02	-5.01	n.a.	n.a.	4.30	12/29/06	1.93	1.78
Royce International Smaller-Companies Fund	-21.43	-8.66	n.a.	n.a.	2.41	6/30/08	2.40	1.74
Royce European Smaller-Companies Fund	-24.23	-10.11	n.a.	n.a.	-1.50	12/29/06	2.67	1.79
<b>QUALIFIED INVESTOR</b>								
Royce Select Fund I	-21.54	-4.90	4.06	10.58	12.42	11/18/98	2.38	2.38
Royce Select Fund II	-22.34	-14.60	0.23	n.a.	3.24	6/30/05	2.80	2.80
Royce Global Select Fund	-19.89	-6.68	8.14	n.a.	10.37	6/30/05	3.53	3.53
Royce SMid-Cap Select Fund	-17.49	-2.40	n.a.	n.a.	-1.32	9/28/07	0.71	0.71
Russell 2000 Index	<b>-21.87</b>	<b>-3.53</b>	<b>-1.02</b>	<b>6.12</b>	<b>n.a.</b>	<b>n.a.</b>	<b>n.a.</b>	<b>n.a.</b>

Royce Pennsylvania Mutual Fund's average annual total return for the 35-year period ended 9/30/11 was 13.34%.

<sup>1</sup> Not annualized

<sup>2</sup> This Fund is only open to existing investors and existing relationships.

### Important Performance and Expense Information

All performance information in this newsletter reflects past performance, is presented on a total return basis, reflects the reinvestment of distributions and does not reflect the deduction of taxes that a shareholder would pay on fund distributions or the redemption of fund shares. Past performance is no guarantee of future results. Investment return and principal value of an investment will fluctuate, so that shares may be worth more or less than their original cost when redeemed. Shares redeemed within 180 days (365 days for Royce's Qualified Investor Funds) of purchase may be subject to a 1% redemption fee payable to the Fund (2% for Royce Qualified Investor Funds, and Royce Global Value, International Smaller-Companies and European Smaller-Companies Funds). Redemption fees are not reflected in the performance shown above; if they were, performance would be lower. Current performance may be higher or lower than performance quoted. Current month-end performance information may be obtained at [www.roycefunds.com](http://www.roycefunds.com). All performance and expense information reflects results of the Fund's oldest share Class (Investment Class or Service Class, as the case may be). Gross operating expenses reflect each Fund's gross total annual operating expenses, including management fees, any 12b-1 distribution and service fees, other expenses, and any applicable acquired fund fees and expenses. Net operating expenses reflect contractual fee waivers and/or expense reimbursements. All expense information is reported as of the Fund's most current prospectus. Royce & Associates has contractually agreed to waive fees and/or reimburse operating expenses through April 30, 2012 (April 30, 2013 for Royce Mid-Cap Fund) to the extent necessary to maintain net annual operating expenses, other than acquired fund fees and expenses, to no more than 1.49% for the Service Class of Royce Dividend Value, 100, Low-Priced Stock, Discovery, SMid-Cap Value and Mid-Cap Funds, and to no more than 1.69% for the Service Class of Royce Global Value, International Smaller-Companies and European Smaller-Companies Funds. Royce & Associates has contractually agreed to waive fees and/or reimburse operating expenses through April 30, 2021 to the extent necessary to maintain net annual operating expenses, other than acquired fund fees and expenses, to no more than 1.99% for the Service Class of Royce Discovery, SMid-Cap Value, Mid-Cap, International Smaller-Companies and European Smaller-Companies Funds. For Qualified Investor Funds, annual operating expenses reflect each Fund's total annual operating expenses as of the most current prospectus and include management fees based on 12.5% of their pre-fee, high-watermark total returns in 2010, (+19.0% for Royce Select Fund I, +19.8% for Royce Select Fund II, +27.2% for Royce Global Select Fund and +5.6% for Royce SMid-Cap Select Fund). Each Qualified Investor Fund's respective total annual Fund operating expense ratio was 2.38%, 2.80%, 3.53% and 0.71%. For Royce Select Fund I and Royce SMid-Cap Select Fund, this also included acquired fund fees and expenses. For Royce Select Fund II and Royce Global Select Fund, it included dividends on securities sold short, acquired fund fees and expenses and interest expense on borrowings. Actual management fees will depend on each Fund's future returns. Royce & Associates has contractually agreed to absorb all other operating expenses of each Qualified Investor Fund, other than dividend expense relating to any short selling activity, acquired fund fees and expenses and interest expense on borrowings, when applicable. Acquired fund fees and expenses reflect the estimated amount of the fees and expenses incurred indirectly by the Fund through its investments in mutual funds, hedge funds, private equity funds and other investment companies.

Shares of a Fund's Service, Consultant, R and K Classes bear an annual distribution expense that is not borne by the Fund's Investment Class. The Royce Funds invest primarily in securities of micro-cap, small-cap and/or mid-cap companies, which may involve considerably more risk than investments in securities of larger-cap companies (see "Primary Risks for Fund Investors" in the respective Prospectus). Please read the Prospectus carefully before investing or sending money. Russell Investment Group is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Russell Investment Group. The Russell 2000 is an unmanaged, capitalization-weighted index of domestic small-cap stocks that measures the performance of the 2,000 smallest publicly traded U.S. companies in the Russell 3000 Index.

## Charlie Dreifus Takes on Large-Caps



Charlie Dreifus, manager of **Royce Special Equity Fund (RSEFX)** launched a new fund, **Royce Special Equity Multi-Cap Fund (RSEMXX)**, on December 31, 2010. Like the original Fund, it seeks long-term growth of capital by using an intensive value approach that combines classic value analysis, the identification of good businesses and accounting cynicism. In our current

low-interest rate environment, Charlie believes this fund's attention to dividends will also prove rewarding. Where it differs is in the market capitalization of the companies in which it invests: a significant portion of its assets will be invested in mid-cap and large-cap companies with market capitalizations of more than \$5 billion.

"In my opinion, the large-cap asset class has looked cheap for a long time," says Dreifus. "I started investing in the space personally during the crisis of 2008-2009 and believe that over the next 10 years, there will likely be rotation in leadership from small-cap to large-cap." Rate of return is a function of entry price, and recent prices in large-caps are very attractive as many are underappreciated. This is not to say that I don't still believe we can find attractive small-cap companies that can provide good returns. In fact, to the contrary, the current environment is ripe for increased merger and acquisition and other transactional activity that can bode well for small-caps and can drive them to potentially outperform over the next one to two years.

Dreifus applies the same methodology and metrics to both Funds. "I still look for high, sustainable returns on invested capital and strong levels of free cash flow from operations, among other attributes. I'm still going to buy companies on an absolute basis and it won't be uncommon to see many household, 'dividend aristocrat' type names." He scours the financial statements of the companies he's considering for investment. "The financials become a mosaic of the company for me. I read them from back to front starting with the footnotes. They help me to gain an understanding of the company's culture that will either support my belief in whether earnings will persist into the future or not. I've been doing this for more than 40 years and this practice allows me to hear what the financial statements of a company are saying."

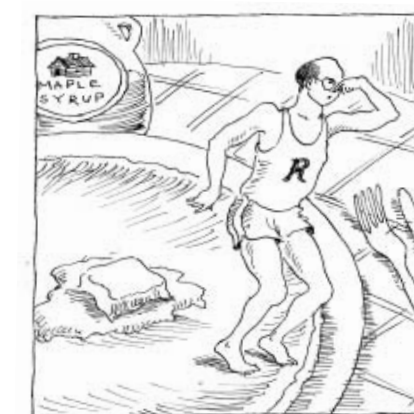
Dreifus believes that the next decade will parallel the early 1970s in that in those years there was a group of companies coined the "Nifty Fifty," blue-chip, large-cap American stocks with strong earnings growth that outperformed the broader market during the early part of that decade. "Today and for the unforeseeable future, with interest rates low, there is a need for a bond surrogate. The aging population is and will be searching for stability and income and there are very few alternatives. I suggest that the Nifty Fifty of the next generation will be a portfolio of companies who have the capacity to, and have had a history of, increasing dividends." These companies are high quality with stable earnings and cash flow such that they have the capacity to pay and grow dividends over time.

The thoughts expressed here are solely those of Mr. Dreifus, and may differ from those of other Royce investment professionals, or the firm as a whole. There can be no assurance with regard to future market movements. **This material is not authorized for distribution unless preceded or accompanied by a current prospectus. Please read the prospectus carefully before investing or sending money.** Royce Special Equity Fund invests primarily in small-cap and micro-cap stocks, which may involve considerably more risk than investing in larger-cap stocks (Please see "Primary Risks for Fund Investors" in the prospectus). Royce Special Equity Multi-Cap Fund invests primarily in the equity securities of mid- and larger-cap companies with market capitalizations of more than \$5 billion.

As of 9/30/11, both Funds held a limited number of stocks, which may involve considerably more risk than a less concentrated portfolio because a decline in the value of these stocks would cause the Fund's overall value to decline to a greater degree.

► This article is excerpted from a recent interview with Charlie Dreifus. To read the interview, visit [www.roycefunds.com/MultiCap](http://www.roycefunds.com/MultiCap).

Regardless of market cap, when it comes to stock selection and portfolio construction, Charlie's cautious approach to risk is akin to that of jumping off of a pancake, by no means an extreme sport.



### FOLLOW ROYCE ON TWITTER AND RSS.

Now it's easier than ever to get the latest from *The Royce Funds*. Subscribe to our RSS feed or follow us on Twitter at:

📄 [www.roycefunds.com/rss](http://www.roycefunds.com/rss)

🐦 [www.twitter.com/RoyceFunds](http://www.twitter.com/RoyceFunds)