

Spring 2011

The Royce Funds
Shareholder Newsletter

RWord

The Market Was Placid While the World Was Wild

Chuck Royce on First Quarter 2011

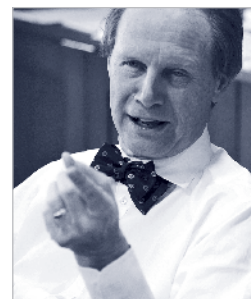
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Were you surprised that the stock market was so placid amidst all of the world's tumult and tragedy during the first quarter?

I was very surprised that the markets were so placid. Stocks performed well in the first quarter in spite of some extraordinary events in the world, starting with Tunisia and Egypt and moving on through the devastation in Japan and more unrest in Libya and other countries in the Middle East. The super-sized headlines were almost disorienting, following on one another so quickly. Yet all of these dramatic and significant events had almost no major impact on the markets. Looking at both the Russell 2000 and the S&P 500, there were a total of five declines of more than 2% per day through the quarter, four for the Russell 2000 and one for the S&P 500. Two of the small-cap index's declines were in January and the S&P 500's was in February.

The market has shown an almost disturbing tendency to look at the bright side of things. At Royce, we've certainly been in the more optimistic camp since the financial crisis in the fall of 2008, but now we're concerned that the market seems to see everything that happens in the world in such a positive light. You can see this most clearly in the market's decidedly bearish reactions last spring to the BP disaster, the European debt crisis and the threat of a double-dip recession versus the far more bullish response to this year's events. I was definitely expecting a downturn somewhere in the neighborhood of at least 7%, but the market didn't even come close to that. It may have something to do with the fact that what's happening in Japan is a great human tragedy, but not a great financial tragedy, at least as of right now. The financial crisis in 2008 was a systemic threat, and therefore very scary for the markets in a way that natural disasters, for all their devastation, are not.

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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

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Do you think that recent events are likely to impede the pace of the economic recovery?

In the short run I think we’ll see some interruptions, especially as Japan struggles to get back on its feet. It’s a major force in the global economy, and already we’ve seen attempts at measuring what the near-term impact will be on manufacturing and global supply chains. However, I think that Japan will recover and that the effects of its woes on the global economy should be relatively short lived. I also believe that the stock market’s momentum will slow as the economy continues to gain strength. This may seem counter-intuitive until one remembers that the market, especially as measured by small-cap stocks, has enjoyed a terrific rally both from the bottom in March 2009 and from July 2010’s interim low. From July 6, 2010 through March 31, 2011, the Russell 2000 gained 44.2%. So a slackening of that feverish pace should not be surprising, even in the context of a growing economy.

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Do you still believe that quality stocks, regardless of market cap, are likely to lead the market?

Yes, and I think it may have already begun. Funds that focus on quality stocks, which we define as those with great balance sheets, high returns on invested capital and the ability to generate free cash flow, were among our top performers in the first quarter. It seems overdue because my initial expectation was that the financial crisis would make investors far more discriminating and wary of risk, yet the rally that began in March 2009 was dominated in its early stages by lower-quality, higher-risk stocks. More recently, however, I’ve been seeing more and more quality businesses enjoy the kind of interest from investors that I thought I’d see two years ago.

4

Are you still optimistic about the long-term prospects for equities?

Absolutely. I am still expecting that longer-term average annual returns are more likely to fall in the upper single to low double digits, especially for the decade as a whole. I believe that small-cap stocks should fully participate, even in what I anticipate will be a highly cyclical market characterized by frequent rotations in leadership. I also think that investors will continue to move back to equities, which will obviously help to boost returns.



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 March 31, 2011

CATEGORY Fund	Average Annual Total Returns						Annual Expenses	
	First Quarter 2011*	One- Year	Five- Year	10- Year	Since Inception	Inception Date	Gross Operating Expenses	Net Operating Expenses
CORE								
Royce Pennsylvania Mutual Fund	9.10%	26.81%	4.81%	11.21%	n.a.	n.a.	0.92%	0.92%
Royce Heritage Fund	7.52	30.39	6.91	11.70	15.25%	12/27/95	1.51	1.51
CORE + DIVIDENDS								
Royce Total Return Fund	6.35	22.31	4.11	9.45	11.50	12/15/93	1.19	1.19
Royce Dividend Value Fund	6.16	27.04	7.05	n.a.	9.69	5/3/04	2.09	1.54
FOCUSED								
Royce Premier Fund**	10.07	30.48	7.98	13.26	13.14	12/31/91	1.15	1.15
Royce Special Equity Fund	5.65	17.51	7.40	12.05	9.71	5/1/98	1.17	1.17
Royce Value Fund	10.04	31.17	7.03	n.a.	13.40	6/14/01	1.47	1.47
Royce 100 Fund	8.30	26.19	7.19	n.a.	13.16	6/30/03	1.54	1.49
OPPORTUNISTIC THEMES								
Royce Low-Priced Stock Fund**	6.96	34.60	7.79	12.12	14.02	12/15/93	1.62	1.51
Royce Opportunity Fund	6.71	26.50	4.61	11.26	13.81	11/19/96	1.22	1.22
Royce Value Plus Fund	6.86	21.63	2.62	n.a.	13.81	6/14/01	1.47	1.47
MICRO-CAP								
Royce Micro-Cap Fund**	7.51	33.50	7.82	13.27	14.20	12/31/91	1.60	1.60
Royce Discovery Fund	6.30	20.82	0.35	n.a.	6.14	10/3/03	3.56	1.49
MID-CAP								
Royce SMid-Cap Value Fund	8.65	27.88	n.a.	n.a.	6.54	9/28/07	2.04	1.50
Royce Mid-Cap Fund	7.08	20.95	n.a.	n.a.	21.14	12/31/09	1.75	1.49
GLOBAL/INTERNATIONAL								
Royce Global Value Fund	4.53	37.14	n.a.	n.a.	11.30	12/29/06	2.07	1.88
Royce International Smaller-Companies Fund	4.12	26.95	n.a.	n.a.	12.52	6/30/08	3.12	1.80
Royce European Smaller-Companies Fund	5.65	37.72	n.a.	n.a.	4.89	12/29/06	3.28	1.76
QUALIFIED INVESTOR								
Royce Select Fund I	8.27	20.45	8.83	13.39	15.31	11/18/98	0.03	0.03
Royce Select Fund II	4.24	21.69	6.00	n.a.	9.62	6/30/05	0.69	0.69
Royce Global Select Fund	4.12	32.17	12.33	n.a.	16.10	6/30/05	0.17	0.17
Royce SMid-Cap Select Fund	7.86	19.24	n.a.	n.a.	4.47	9/28/07	0.04	0.04
Russell 2000 Index	7.94	25.79	3.35	7.87	n.a.	n.a.	n.a.	n.a.

Royce Pennsylvania Mutual Fund's average annual total return for the 35-year period ended 3/31/11 was 14.19%.

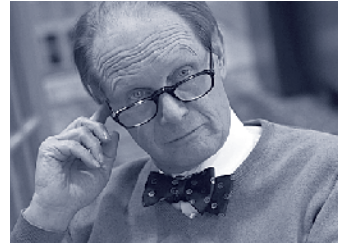
* Not annualized

** This Fund is only open to existing investors and existing relationships.

Important Performance and Expense Information

All performance information in this piece 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 of purchase may be subject to a 1% redemption fee payable to the Fund (2% for 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. 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, 2011 to the extent necessary to limit total 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, 2020 to the extent necessary to limit total net annual operating expenses, other than acquired fund fees and expenses, to no more than 1.99% for the Service Class of Royce Dividend Value, Discovery, SMid-Cap Value, International Smaller-Companies and European Smaller-Companies Funds. Annual operating expenses reflect each Select 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. There was no high watermark return for Royce Select Fund I, Select Fund II, Global Select Fund and SMid-Cap Select Fund for 2009, and each Fund's respective total annual Fund operating expense ratio was 0.03%, 0.69%, 0.17% and 0.04%, respectively. For Royce Select Fund I and Global Select Fund, this consisted of dividends on securities sold short and acquired fund fees and expenses. For Royce Select Fund II and SMid-Cap Select Fund, it consisted of 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 the Fund, other than dividend expense relating to any short selling activity of the Fund, 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 any applicable 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. 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.



Steven McBoyle, Whitney George and Chuck Royce

The Golden Mean? Looking at SMid-Caps

SMid-cap portfolios represent a logical extension of Royce's core research capabilities in the small-cap universe, allowing us ongoing use of our institutional knowledge as companies we know well move up (and down) the cap spectrum.

The emerging acceptance of small-cap stocks as a permanent part of an investor's portfolio, combined with the traditionally dominant allocation to large-cap stocks,

has created a meaningful investment opportunity in those stocks that fall in between. SMid-cap managers have a large selection universe, with strong historical performance characteristics, lower volatility and greater liquidity than small-cap, while also boasting greater financial resources and business stability.

Our own work in this area includes two newer portfolios that recently marked their third anniversaries:

Royce SMid-Cap Value Fund

- Steven McBoyle and Whitney George, Portfolio Managers

Royce SMid-Cap Select Fund

(Available only to qualified investors)

- Steven McBoyle, Portfolio Manager; Chuck Royce, Assistant Portfolio Manager

See Fund performance information inside or at www.roycefunds.com

➤ For the full story on Royce's Smid-Cap Funds, go to www.roycefunds.com/smidcap

Another Look at Royce

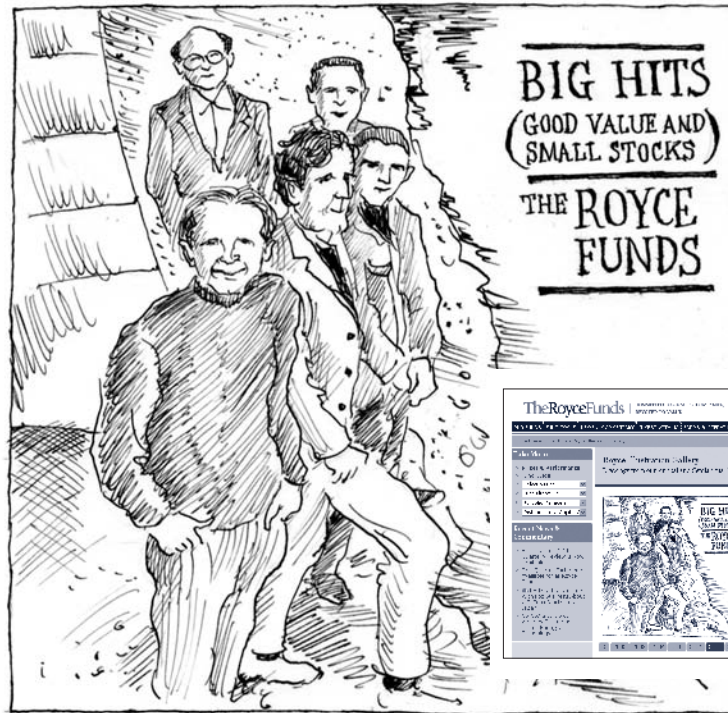
Drawings from our Annual and Semiannual Reviews, Now Online!

In the long list of materials that *The Royce Funds* produces to help you better understand what we do and how our Funds perform, none captures the effort as well as our *Annual and Semiannual Report and Review To Shareholders*. For more than 10 years, artist Hank Blaustein has collaborated with us to illustrate the events that inform our perspective on investing.



Born and raised in Brooklyn, NY, Hank has been drawing the world around him since he was first able to hold a pencil.

His goal has always been to capture the essence and personality of the people, places and things that surround him, acting as both an artist and a journalist. He has illustrated for *The New Yorker* magazine, *Newsday* and



- See our gallery of over fifty custom illustrations
- Read a choice excerpt from the *Letter to Our Shareholders*
- Navigate through the decade at the click of a button



Grant's Interest Rate Observer, among many others, and has exhibited his work in Austria and Italy.

We invite you to stop by our new online illustration gallery at www.roycefunds.com/illustration to see for yourself.

15 Years for Royce Heritage Fund

Royce Heritage Fund recently celebrated its 15th anniversary, an important milestone that we think is well-worth commemorating.

The Fund utilizes our core approach, with companies selected using our tried and true criteria of balance sheet strength, high returns on invested capital and cash flow characteristics. The Fund's investment goal is long-term growth of capital. It can invest across a wide market cap range, including micro-caps, small-caps and mid-caps, and makes use of its ability to invest in non-U.S. securities (about 24.0% of net assets as of 3/31/11. Subject to change.)

Charles M. Royce, President and Co-Chief Investment Officer of Royce, serves as the Fund's lead portfolio manager. James J. Harvey manages the Fund with him. The Fund's inception date is 12/27/95.

See Fund performance information on the preceding page, or at www.roycefunds.com

➤ For the full story on Royce Heritage Fund's 15th anniversary, visit www.roycefunds.com/heritage15.



Jim Harvey and Chuck Royce

Making Headlines

Royce investment personnel, and *The Royce Funds*, are often cited in the media. Four particularly prominent items appeared recently, and merit special mention.



Morningstar Fund Spy

December 1, 2010—*Morningstar Fund Spy's* "How a Fund Boutique Grew Without Losing Its Soul" appeared

as the Corporate Culture portion of Morningstar's Stewardship Grade for Funds for the Royce Fund family.



Louis Rukeyser's Mutual Funds

February 2011—*Louis Rukeyser's Mutual Funds* featured an interview with Royce Global Value Fund's David Nadel.



SmartMoney

February 2011—*SmartMoney* included an article entitled "America's Best Mutual Fund Managers" which featured Royce Low

Priced-Stock Fund Manager Whitney George. *SmartMoney* praised the fund saying: "The average annual returns of George's Low-Priced Stock fund exceeded 10 percent over the past decade—a time when the broader market posted returns closer to zero."

BROADCAST



Consuelo Mack WealthTrack

February 4, 2011—Chuck Royce was a guest on public television's *Consuelo Mack WealthTrack*. Mack described it as a "television interview with investment legend, Charles "Chuck" Royce, whose name is synonymous with small company stocks."

➤ To read the complete articles, visit www.roycefunds.com/headlines

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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:

- Wild World, Placid Market: Chuck Royce on First Quarter 2011
- Looking at SMid-Caps
- 15 Years for Royce Heritage Fund
- Illustrations From Royce Shareholder Reports
- Making Headlines
- Fund Performance Update

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