

The Royce Funds Show Shift, Outperform YTD

Royce's Co-CIOs, President Chris Clark and Managing Director Francis Gannon respond to questions from clients about many Royce Funds' recent performance turnaround.



FG In a number of recent client meetings, we were asked about the turnaround in many of our Funds' returns. Wanting to understand the

factors leading to these strong results, our clients were also curious about whether we expect this shift to be long lasting. It's clear why they asked. As you can see from the bar graph, most of our domestic small-cap funds, specifically those that use the Russell 2000 Index as a benchmark, outperformed the small-cap index during 1Q16, some very significantly.

CC Certain market movements keyed the reversal as did moves that we made internally. The market only recently began to reward profitability and recognize how low valuations had become outside the narrow areas that worked in 2015. Our strategies lean to varying degrees towards value, quality, and/or cyclical companies. Until this year, these factors were distinctly out of favor. Investors preferred fast-growing, higher leverage, non-earning, and/or non-cyclical companies, most notably in biotech. For reasons we detail elsewhere, we believe that all of these trends have reversed, and that the countermove, which we expect to be long lasting, will be favorable to the way that many of our managers invest.

Royce Funds Gain Momentum YTD

YTD Performance¹ of U.S. Small-Cap Royce Funds² vs Russell 2000 through 3/31/16 (%)



¹ Not annualized

² Chart shows the Investment Class of domestic small-cap Royce Funds that use the Russell 2000 Index as a primary benchmark.

Royce Outperformance is Strong in the Current Market Cycle

Market Cycle¹ Results from U.S. Small-Cap Royce Funds² vs Russell 2000

 % of Funds Outperforming in Period

	7/13/07 PEAK TO: TROUGH 3/9/09 (%)		4/29/11 PEAK TO: TROUGH 10/3/11 (%)		6/23/15 PEAK TO: CURRENT 3/31/16 (%)
Russell 2000	-58.9	6.6	-29.1	58.5	-13.0
Dividend Value	-52.9	22.5	-25.1	40.9	-5.9
Heritage	-56.4	26.2	-29.9	22.9	-5.5
Low-Priced Stock	-55.7	28.5	-30.2	-3.9	-16.4
Opportunity	-69.2	6.9	-35.8	47.7	-15.6
Pennsylvania Mutual	-57.0	11.6	-27.6	36.2	-8.7
Premier	-49.0	29.9	-24.6	29.7	-10.0
Small-Cap Leaders	-49.7	28.4	-30.4	24.0	-10.1
Small-Cap Value	-54.1	18.4	-28.7	22.6	-7.3
Smaller-Companies Growth	-58.7	-1.7	-29.3	46.7	-16.0
Special Equity	-42.7	20.8	-20.6	43.4	-9.1
Total Return	-54.2	6.8	-22.5	44.8	-6.1
Number of Funds Outperforming in Period	10/11	10/11	6/11	0/11	8/11

¹ Royce defines market cycles as peak-to-peak periods in which a peak is the market high prior to a decline of at least 15%.

² Table shows Investment Class of domestic small-cap Royce Funds that use the Russell 2000 Index as a primary benchmark.

However, this change did not suddenly occur during the last three months; it started when the Russell 2000 reached a peak last summer. You can see that in the market cycle table, where once again most of our domestic small-cap funds outperformed the Russell 2000 handily from the small-cap peak on 6/23/15 through 3/31/16. This table also shows how anomalous the last cycle was for many Royce Funds. History shows that, though we typically outperform over full market cycles, we did not in the last cycle.

FG This shift is also about the steps we took to streamline our offerings—we rationalized our portfolio line-up, going from 28 open-end funds to 18 over the last two years. I think that's why the most recent cycle looks more like some of the previous market cycle periods in which we generally outperformed. This is one of our goals—to give investors strong absolute and relative results over full market cycles.

CC So while the shift in small-cap stretches back more than nine months, our internal effort began two years ago when we started working to create more meaningful differentiation among our portfolios and to provide our portfolio managers with even more quantitative

resources. Our Fund Framework offers one way to see the fruit of these efforts, though the recent market cycle and first-quarter returns might offer an equally significant demonstration.

Certain market movements keyed the reversal as did moves that we made internally. The market only recently began to reward profitability and recognize how low valuations had become outside the narrow areas that worked in 2015.

FG I think everyone feels like a lot of the hard work we've been doing has begun paying off. The last few years when most of our approaches were out of favor were very challenging. Of course, we also made our share of mistakes. But we've made important changes. We added more dedicated analysts and quantitative resources while striving to improve and refine the advantages we already had in place—the best and deepest small-cap research platform in the industry and unmatched access to company managements.

We couldn't be happier about the progress we've made—but we fully understand that this is only the beginning of the process. We are fully committed to ensuring that Royce remains preeminent in the small-cap space.

CC These moves allow our portfolio managers to execute on a distinct investment discipline within one of our value, core, and/or growth approaches, aligning them with the strategy that works best with their experience. This exclusive focus frees them up to do what they do best.

FG We couldn't be happier about the progress we've made—but we fully understand that this is only the beginning of the process. We are fully committed to ensuring that Royce remains preeminent in the small-cap space. Our position as independent thinkers with unparalleled knowledge and experience in small-cap investing is something that we take very seriously. We expect a great deal of ourselves and know that our shareholders and clients do as well.

CC Absolutely, we can't predict future results, but we did see the recent downturns, which we saw as a strong signal to buy, as a major market inflection point in which profitability and low leverage will matter more and more to investors for the next few years, if not longer.



See Fund Performance and Expenses on the back

Mr. Clark's and Mr. Gannon's thoughts in this piece concerning the stock market are solely their own and, of course, there can be no assurance with regard to future market movements. Past performance is no guarantee of future results. For more information on performance and risk please see the back page.

Performance and Expenses

As of March 31, 2016

FUND	1Q2016 ¹	1-YR	AVERAGE ANNUAL TOTAL RETURNS (%)					40-YR/ SINCE INCEPT.	INCEPTION DATE	ANNUAL OPERATING EXPENSES (%)	
			5-YR	10-YR	20-YR	GROSS	NET				
U.S. EQUITY											
Dividend Value	5.13	-1.72	6.17	6.71	N/A	8.28	5/3/04	1.29	1.29		
Heritage	4.90	-2.96	3.58	5.30	12.13	12.29	12/27/95	1.17	1.17		
Low-Priced Stock	-0.64	-11.26	-3.90	1.89	8.94	9.78	12/15/93	1.17	1.17		
Opportunity	2.08	-12.74	4.73	4.67	N/A	11.39	11/19/96	1.15	1.15		
Pennsylvania Mutual	6.22	-6.99	4.92	4.87	9.92	12.99	N/A	0.92	0.92		
Premier	4.41	-8.34	3.64	5.79	10.54	11.11	12/31/91	1.10	1.10		
Small-Cap Leaders	5.25	-8.12	2.59	4.94	N/A	8.96	6/30/03	1.22	1.22		
Small-Cap Value	9.38	-6.10	2.93	5.06	N/A	9.81	6/14/01	1.18	1.18		
Smaller-Companies Growth	-4.31	-10.16	4.83	3.86	N/A	10.79	6/14/01	1.34	1.25		
Special Equity	5.63	-9.60	5.76	6.57	N/A	8.59	5/1/98	1.12	1.12		
Total Return	5.17	-4.09	6.80	5.44	9.84	10.43	12/15/93	1.19	1.19		
INDEX											
Russell 2000 Index	-1.52	-9.76	7.20	5.26	7.68	N/A	N/A	N/A	N/A		

¹ Not Annualized

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. Investment and Service Class shares redeemed within 30 days of purchase may be subject to a 1% redemption fee payable to the Fund. Redemption fees are not reflected in the performance shown above; if such fees were reflected, performance would be lower. Current month-end performance may be higher or lower than performance quoted and may be obtained at www.roycefunds.com. All performance and expense information reflect results of the Fund's Investment Class shares. Gross operating expenses reflect each Fund's gross total annual operating expenses and include 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 exclusive of any applicable acquired fund fees and expenses. All expense information is reported as of the Fund's prospectus dated 5/1/15. Royce & Associates has contractually agreed to waive fees and/or reimburse operating expenses through April 30, 2016 to the extent necessary to maintain net annual operating expenses (excluding brokerage commissions, taxes, interest, litigation expenses, acquired fund fees and expenses, and other expenses not borne in the ordinary course of business) to no more than 1.24% for the Investment Class of Royce Smaller-Companies Growth Fund. 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.

All performance and risk information presented in this material prior to the commencement date of Investment Class shares on 9/14/07 for Royce Dividend Value Fund, 3/15/07 for Royce Heritage, Low-Priced Stock, Small-Cap Leaders, Small-Cap Value, and Smaller-Companies Growth Funds. Service, Consultant, R, and K Class shares 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). The Funds may also invest in varying degrees in foreign securities which may involve political, economic, currency, and other risks not encountered in U.S. investments. 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 Index 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. Index returns include net reinvested dividends and/or interest income. The performance of an index does not represent exactly any particular investment, as you cannot invest directly in an index. Distributor: Royce Fund Services, Inc.

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CIO-BRO-0316