



# Risk, Volatility, and Royce Total Return Fund

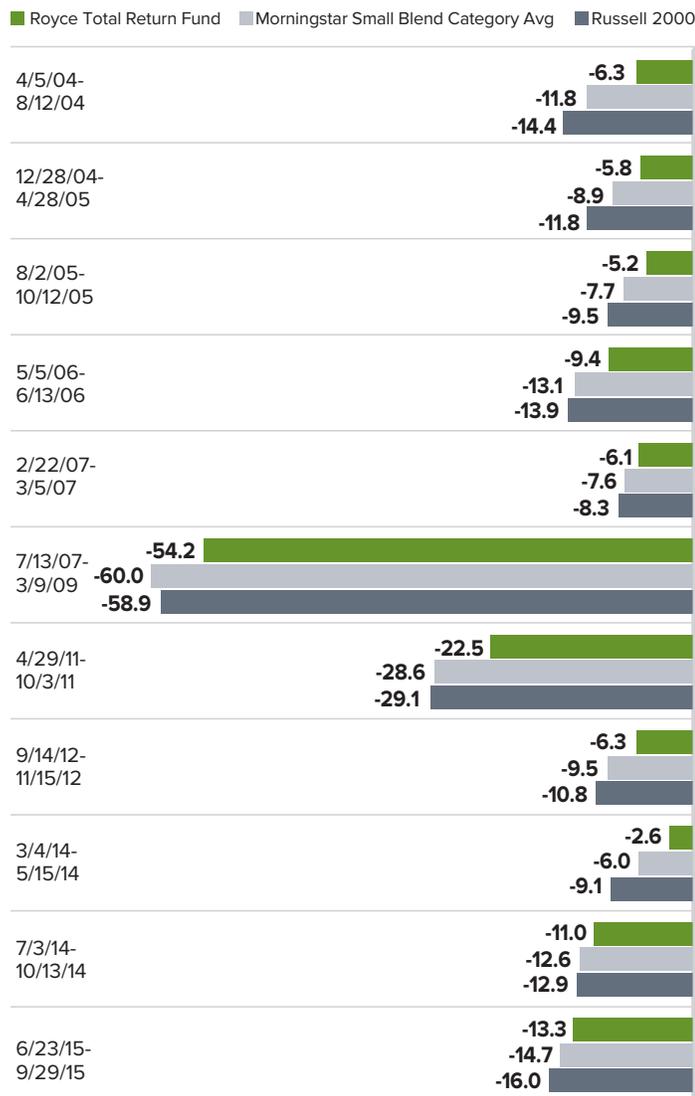
In many ways, Royce Total Return Fund was designed to seek better downside protection and risk-adjusted returns. The broadly diversified portfolio of dividend-paying small-cap stocks has always been built in an attempt to provide a potential cushion against the extremes of market volatility, particularly when markets were correcting. We seek to meet these goals by investing in companies that possess strong balance sheets, solid fundamentals, and what we think are attractive valuations.

TheRoyceFunds

We are pleased that these goals have largely been met since the Fund's inception on 12/15/93. Total Return beat both its small-cap benchmark, the Russell 2000 Index, and its peer average in the Morningstar U.S. Small Blend Category in all 11 downturns of 7.5% or more over the past 15 years.

**Down Market Performance Comparison and Morningstar Small Blend Average<sup>2</sup> (%)** Through 12/31/15

The Fund outperformed the Russell 2000 during all 11 downturns of 7.5% or more from the index's high over the last 15 years.



The Fund also boasted better downside capture than the Morningstar U.S. Small Blend Category Average. Better down market results have been critical to delivering consistently attractive risk-adjusted returns. For example, in 97% of the rolling five-year periods over the past 15 years, the Fund beat its Small Blend peers on a risk-adjusted return basis, as measured by Sharpe ratio.

<sup>1</sup>1,487 US Small Funds tracked by Morningstar with at least five years of performance history as of 12/31/15.  
<sup>2</sup>567 US Small Blend Funds tracked by Morningstar with at least five years of performance history as of 12/31/15.

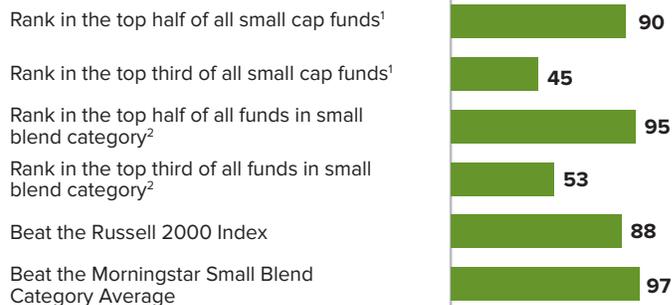
**Downside Capture vs. Russell 2000 (%)**

From Royce Total Return Fund's First Full Quarter (12/31/93) Through 12/31/15



**Royce Total Return Fund Sharpe Ratio Results (%)**

% of 5-Year Monthly Rolling Sharpe Ratios Over the Last 15 Years (12/31/00-12/31/15), That:



We are also pleased with the Fund's long-term record in more volatile markets. Before examining Total Return's historical results, it's worth pointing out that at Royce we view volatility as an ally when selecting stocks. We agree with Warren Buffett, who once said, "Look at market fluctuations as your friend rather than your enemy; profit from folly rather than participate in it."

So while many investors think of volatility as synonymous (or nearly so) with risk, we take a different view. Rather than avoid volatility, we see the challenge of managing risk as trying to take advantage of the market's movements—an essential skill for any successful active manager.

Those times when the market cannot seem to make up its mind are exactly when securities tend to be most attractively mispriced. And therein lies one of the keys to outperformance for active managers—the identification and purchase of mispriced securities.

While volatility typically signals a downward shift in returns, our recent research found that outperformance for active managers has not been limited to flat or down market periods.

This study used standard deviation to measure volatility and looked at monthly rolling three- and five-year standard deviations from Total Return's first full month of performance (that is, starting from 12/31/93) through 12/31/15. This gave

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us a large number of data points spanning more than 20 years—229 for the three-year period and 205 for the five-year period. We then sorted the annual standard deviations from highest to lowest and divided them into quintiles. For each monthly rolling period in each quintile we looked at the corresponding outperformance of the Fund and the Morningstar U.S. Small Blend Category Average versus the Russell 2000. The results are in the following table:

**Volatility and Small-Cap Performance Spreads (%)**

From 12/31/93 through 12/31/15

	QUINTILE				
	1	2	3	4	5
<b>Average of 3-Year Monthly Rolling Statistics</b>					
Average Russell 2000 Standard Deviation	13.28	15.80	20.18	22.81	25.96
Average Russell 2000 Performance	14.58	16.81	8.44	5.94	0.52
Average Morningstar Small Blend Category Performance	14.75	16.79	9.16	8.80	1.99
Average Morningstar Small Blend Category Performance Spread <sup>1</sup> vs Russell 2000	0.18	-0.02	0.72	2.86	1.47
Average Royce Total Return Fund Performance	15.11	15.62	11.00	10.42	4.18
Average Royce Total Return Fund Spread vs Russell 2000	0.53	-1.19	2.56	4.48	3.65

**Average of 5-Year Monthly Rolling Statistics**

Average Russell 2000 Standard Deviation	16.02	18.51	20.98	22.47	24.21
Average Russell 2000 Performance	13.00	12.43	7.22	5.95	2.19
Average Morningstar Small Blend Category Performance	12.95	12.75	9.06	8.53	2.97
Average Morningstar Small Blend Category Performance Spread <sup>1</sup> vs Russell 2000	-0.05	0.32	1.84	2.58	0.77
Average Royce Total Return Fund Performance	13.06	12.76	10.61	10.33	5.01
Average Royce Total Return Fund Spread vs Russell 2000	0.06	0.32	3.40	4.38	2.82

<sup>1</sup> Average of all funds in the US Open End Small Blend Category tracked by Morningstar with at least 12 months of history as of the relevant month end. Source: Morningstar Direct

We found that, on average, active management (including Total Return) had a mixed but mostly positive record versus the Russell 2000 during periods of lower volatility. The average standard deviations for the Russell 2000 in the lowest quintile of volatility for each respective period were 13.28% and 16.02%. During these three- and five-year periods, Total Return outpaced the benchmark, though the respective performance spreads were comparatively narrow.

As volatility increased, we saw a more pronounced performance advantage for Total Return. The Fund enjoyed its widest outperformance spreads in Quintiles 3, 4, and 5 of volatility. In these periods Total Return had sizable advantages over both its benchmark and its peers in the Morningstar U.S. Small Blend category.

It's important to note that this is a correlation—we are not suggesting that volatile markets caused the Fund, or active management more generally, to do better, only that an examination of history reveals this correlation.

It's also worth pointing out that for most of the last five-plus years, volatility fell and remained low. This created a more challenging environment for active managers. However, this has begun to change, in particular for small-cap stocks, which have been growing steadily more volatile since the second quarter of 2014. We think that this should ultimately bode well for risk-conscious active small-cap managers.

Equally important is that all of these results are consistent with how we have sought to manage the Fund throughout its more than 20 years of history. We saw the potential for better downside protection by using a disciplined, value-based approach to invest in dividend-paying small-caps. Needless to say, we are very pleased that history has supported the effectiveness of this strategy.

**See Fund Performance and Expenses on the back**

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## Performance and Expenses

Average Annual Total Return (%) Through 12/31/15

	4Q2015*	1-YR	3-YR	5-YR	10-YR	15-YR	20-YR	SINCE INCEPTION (12/15/93)
Royce Total Return Fund	1.86	-7.19	7.68	7.03	5.86	8.28	9.82	10.30
Russell 2000	3.59	-4.41	11.65	9.19	6.80	7.28	8.03	8.56

Annual Operating Expenses: 1.19%

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\*Not Annualized

### Important Performance and Expense Information

All performance information 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 30 days of purchase may be subject to a 1% redemption fee. All redemption fees are payable to the Fund and 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](http://www.roycefunds.com). Operating expenses reflect the Fund's total annual operating expenses for the Investment Class as of the Fund's most current prospectus and include management fees, other expenses, and acquired fund fees and expenses. 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.

*The Fund invests primarily in small-cap stocks, which may involve considerably more risk than investing in larger-cap stocks. (Please see "Primary Risks for Fund Investors" in the prospectus.) The Fund's broadly diversified portfolio does not ensure a profit or guarantee against loss. The Fund may invest up to 25% of its net assets in foreign securities (measured at the time of investment), which may involve political, economic, currency, and other risks not encountered in U.S. investments. (Please see "Investing Foreign Securities" in the prospectus.)*

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