

Royce Total Return Invmt RYTRX

A solid option for conservative investors seeking exposure to small-cap stocks.

Morningstar's Take RYTRX

Morningstar Rating ★★★

Morningstar Analyst Rating Bronze

Morningstar Pillars

Process	+	Positive
Performance	○	Neutral
People	+	Positive
Parent	+	Positive
Price	○	Neutral

Role In Portfolio

Supporting

Fund Performance RYTRX

Year	Total Return (%)	+/- Category
YTD	14.99	4.90
2015	-7.19	-1.81
2014	1.34	-2.45
2013	32.76	-4.63
2012	14.42	-1.04

Data through 9-30-16

10-07-16 | by Andrew Daniels

Royce Total Return's solid managers, distinct approach, and predictable risk/reward profile make the fund a sensible option for conservative investors. It earns a Morningstar Analyst Rating of Bronze.

Chuck Royce has been the lead manager on this fund since its December 1993 inception. He is supported by Jay Kaplan, who joined as comanager in 2005; assistant portfolio managers George Necakov and Chris Flynn came on board here in 2005 and 2007, respectively. Although Royce is in the advanced stage of his career, there are experienced managers on hand to take over when he ultimately steps down.

The managers look for micro- and small-cap dividend-paying stocks to hold for three to five years, emphasizing businesses with solid balance sheets and high profitability ratios trading at reasonable valuations. While 90% of the fund's holdings must pay a dividend, it won't own high-yielding stocks unless they meet the team's quality standards. For example, the fund has historically been underweight

dividend-heavy REITs and utilities because of their high leverage ratios. The managers' preference for firms with strong balance sheets is reflected in the portfolio's lower debt/capital ratio than the Russell 2000 Index's. Similarly, the fund's return on invested capital and return on assets trounce the benchmark's. These quality traits confirm the team's emphasis on risk control and help explain why it has historically provided solid downside protection.

This fund has been a long-term top performer, but it has struggled on a relative-basis in recent years. During the trailing five years ended September 2016, the fund's annualized gain of 13.0% trailed the benchmark's gain of 15.8% and lagged 78% of small-blend peers. This isn't surprising given the bull market that has reigned for most of that period, and the fund's returns do look much better on a risk-adjusted basis. The fund's Sortino ratio--a measure of risk-adjusted returns that emphasizes downside risk--was 1.96 during the same period, beating the benchmark's 1.90. All told, this fund's emphasis on dividend-paying stocks, risk control, and downside protection make it a solid option for conservative investors.

Process Pillar + Positive | Andrew Daniels 10/07/2016

This fund's approach is sensible and long-term oriented, earning it a Positive Process rating.

The managers look to hold dividend-paying firms with market capitalizations up to \$3 billion. By mandate, 90% of the fund's holdings must pay a dividend. However, it won't own high-yielding stocks just for the dividend. For example, it has long been underweight dividend-heavy REITs and utilities. Instead, it emphasizes sound businesses trading at reasonable valuations with strong balance sheets and profitability ratios--such as return on invested capital and return on assets--to mitigate financial risk.

Quality businesses that offer these types of valuations are often experiencing difficulties. The managers spend considerable time trying to identify whether these difficulties are transient or structural and to understand firms' risk/reward profiles. As a result, the fund is one of the least-volatile options in the small-blend Morningstar Category. Once the managers buy, they hold on for the long term. The intended investment horizon is three to five years.

The fund is well-diversified, with nearly 300 holdings and no stock making up more than 1.5% of assets. While the fund's prospectus benchmark is the Russell 2000 Index, the managers are benchmark-agnostic, so expect sector weightings to deviate substantially from the bogy as a result.

Given the fund's focus on firms with low debt that pay dividends, it's no surprise that as of June 2016 the fund's debt/capital ratio of 0.28 was much lower than the Russell 2000 Index's 0.40. The fund's dividend yield of 2.5% also beat the benchmark (1.8%) and typical small-blend peer (1.6%). The managers' intense focus on high returns on invested capital is also apparent: The fund's ROIC of 10.4% trounces the benchmark's negative 2.1%. These quality traits confirm the team's emphasis on risk control and mean the fund will likely provide solid downside protection.

As of June 2016, the fund was significantly overweight industrials stocks at 23% of assets, compared with the benchmark's 14% allocation. Large holdings include industrial product firms Chase CCF and Tennant TNC. The fund's 23% financials stake was more than the benchmark's 16% weighting, driven by insurance firms E-L Financial ELF and Markel MKL, as well as asset managers Federated Investors FII and KKR & Co KKR. On the flip side, the team's focus on conservative balance sheets means it will be underweight real estate investment trusts and utilities despite their above-average dividend yields. Its emphasis on profitability

limits the fund's exposure to biotech and pharmaceutical names.

Performance Pillar ● Neutral | Andrew Daniels
10/07/2016

This fund has been a top performer over the long term, but it has struggled in the post-recession, low-interest-rate environment, earning it a Neutral Performance rating.

Chuck Royce has been at the helm since the fund's December 1993 inception and has posted solid results. Since then through September 2016, the fund has outpaced the Russell 2000 benchmark by an annualized 200 basis points. The fund's strong record can be attributed to its keen eye on risk control: It will provide solid downside protection but tends to lag--but still participate--during market rallies. This profile makes the fund suitable for more-conservative investors.

During the trailing five years ended September 2016, the fund's annualized gain of 13.0% trails the benchmark's gain of 15.8% and lags 78% of small-blend peers. This isn't surprising given the bull market that reigned for most of that period; the fund's returns look much better on a risk-adjusted basis. The fund's Sortino ratio--a measure of risk-adjusted returns that emphasizes downside risk--was 1.96 during the same period, beating the benchmark's 1.90.

The fund has bounced back during the last 12 months, outperforming the benchmark by 3.5 percentage points. Strong stock selection in industrials and basic materials--as well as its lack of poor-performing biotech stocks--drove results.

People Pillar + Positive | Andrew Daniels
10/07/2016

Chuck Royce, who founded Royce & Associates in 1972 and has more than 50 years of investment experience, has been lead manager on this fund since its December 1993 inception. Jay Kaplan joined as a comanager in May 2005 and has taken on additional responsibilities since. Prior to joining the firm in 2000, Kaplan was a managing director and portfolio manager at Prudential Financial. Assistant portfolio managers George Necakov and Chris Flynn came on board in 2005 and 2007, respectively; they

have both been with the firm for more than two decades. Although Royce is in the advanced stage of his career, the fund will remain in good hands when he ultimately steps down. The managers' extensive experience and long tenure with the fund support a Positive People rating.

Six analysts assist the named managers. The researchers have been with Royce for an average of five years, and they average 16 years of industry experience. The team gets additional support from the firm's 14 other portfolio managers, all of whom also serve as analysts.

Royce and Necakov have more than \$1 million invested in this fund. Kaplan has between \$500,001 and \$1 million invested, and Flynn has between \$100,001 and \$500,000 invested.

Parent Pillar + Positive | Andrew Daniels
04/27/2016

Royce & Associates is a specialty small- and mid-cap shop with a strong investment culture, well-incentivized managers, and high manager retention. Fees are an area for improvement, but the firm warrants a Positive Parent Pillar rating. While it is an affiliate of Legg Mason, the firm has retained a large degree of independence. To encourage collaboration and reduce key-manager risk, the firm has added more than one manager to most of its funds. That's important because the managers have limited analyst support.

Managers' interests are aligned with investors'. The firm requires managers to invest large sums in the funds they run. And their compensation is adjusted based on absolute performance relative to Treasury bills and risk-adjusted performance relative to peers. There is also an adjustment based on revenue. It is encouraging that the firm has been responsible about closing funds when opportunities are scarce.

The firm is evolving. During the past few years, it transitioned from a generalist approach to investment teams focused on specialized product suites. The firm has also simplified its fund lineup to reduce product overlap, closing 10 mutual funds since July 2014. And in the near term, Chris Clark, the firm's president and co-CIO, will replace founder

Chuck Royce as CEO. Royce will continue to serve as a portfolio manager.

Price Pillar ● Neutral | Andrew Daniels
10/07/2016

Overall, this fund doesn't provide a fee advantage over peers and thus earns a Neutral Price rating.

More than 60% of this fund's assets are in its no-load Investment share class, which charges 1.22% and earns a Morningstar Fee Level of Average. For comparison, the median net expense ratio for the small-cap no-load peer group is 1.19%. The fund's Institutional share class holds 17% of assets, charges 1.10%, and also earns an Average fee level. The median net expense ratio for the small-cap institutional peer group is 1.00%.

The level-load C share class holds 9% of assets, charges 2.23%, and earns an Above Average fee level in its small-cap level-load peer group. Of the remaining four share classes--which make up 10% of assets--three of them earn either Above Average or High fee levels.