



RBC Funds (Lux) - U.S. Small Cap Equity Fund – Fourth Quarter 2011 Commentary

U.S. equity markets produced sizable gains in the fourth quarter, but almost all of the gains were produced in a rally in October, with equities essentially flat with high volatility in November and December. Prospects for sustained U.S. economic growth improved somewhat in the period, while those for Europe deteriorated due to sovereign debt issues and increased uncertainty with regard to the future of the euro.

Within the U.S. small cap market as represented by the Russell 2000 index, those companies with the lowest price/earnings ratios and the highest beta's were generally the best performers in the fourth quarter. For the full year 2011, low beta and high return on equity were the dominant positive performance factors in the Russell 2000 index. The RBC Funds (Lux) - U.S. Small Cap Equity Fund (the "fund") has a somewhat lower price/earnings valuation, a slightly higher beta, and a significantly higher return on equity than the Russell 2000 index.

All economic sectors of the Russell 2000 produced positive performance in the fourth quarter. The three best performing sectors were energy (+26%), industrials (+19%), and financials (+16%). The fund is heavily overweight compared to the Russell 2000 index in industrials, slightly overweight in energy, and significantly underweight in financials. The weakest performing economic sectors in the Russell 2000 index in the fourth quarter were telecommunication services (+8%), consumer staples (+9%), and utilities (+11%). The fund is underweight compared to the index in consumer staples and utilities, and owns nothing in the tiny telecommunication services sector.

The fund had one full month of investment performance in the fourth quarter. For the month of December, the Fund was up 0.8% compared to a 0.7% return for the Russell 2000, a positive 0.1% differential. The most important positive performance factor in the month was a buyout offer for portfolio holding Delphi Financial Group, at a sizable premium to its public market stock valuation. The biggest detriment to performance relative to the index was the sector underweight in financials, the best performing economic sector in the Russell 2000 in the month of December.

The fund strategy focuses on neglected small cap companies with attractive long-term business fundamentals, near-term profitability improvement potential, and low relative valuations. The strategy emphasizes market leaders with proven products or services, sustainable competitive advantages, solid balance sheets, and attractive cash flows. While sector weightings are a result of bottom-up research and stock selection, the portfolio remains positioned for economic recovery with overweights in the economically-sensitive industrials, consumer discretionary, materials, and energy sectors. Downside protection is provided by the superior return on equity and balance sheet profile of the portfolio compared to the Russell 2000, and its discounted valuation metrics compared to the index.



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