

## Fund Commentary

### Forward Global Emerging Markets Fund Market Review and Global Outlook Second Quarter, 2007

Average annual returns as of 06/30/07	1YR	3YR	5 YR	10YR	Since Inception (10/04/95)
Forward Global Emerging Markets Fund— Institutional Share Class	45.14%	36.99%	31.34%	9.52%	10.11%
MSCI Emerging Markets Index	45.45%	38.67%	30.66%	10.25%	10.57%

	Gross Expense	Net/Actual Expense
Forward Global Emerging Markets Fund (Institutional Share Class)	1.90%	1.39%

*The performance quoted represents past performance and does not guarantee future results. Current performance may be lower or higher than the performance quoted. The investment return and principal value of an investment will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Performance quoted does not reflect the non-recurring redemption fee of 2% that may be charged if shares are sold or exchanged within 180 days of the purchase date. If these fees were reflected, the performance quoted would be lower. Investment performance reflects fee waivers in effect. In the absence of fee waivers, total return would be lower. Total return is based on NAV, assuming reinvestment of all distributions. Performance does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or the redemption of Fund shares. Performance data current to the most recent month end may be obtained at [www.forwardfunds.com](http://www.forwardfunds.com).*

### Fund Manager's Report

Emerging equity markets enjoyed a robust quarter with the MSCI benchmark index rising by 5.0%. Our performance was rather weaker, producing a 13.9% gain as our value bias remained out of favor and momentum investing continued to benefit. China and India both rose by over 20%. In contrast, our key overweight in Taiwan has struggled in this environment and has showed greater correlation with developed markets. The largest positive contributors during the period were South Africa, Turkey, and Thailand with negative contribution from North East Asia, Russia, and Israel.

Europe, the Middle East, and Africa (EMEA) [+58 bps], as a whole, produced a positive net performance effect although this hides a number of large gains and losses. Losses in **Russia** [-32 bps] were entirely due to stock selection. The fund gave up ground in the energy sector due to underweight Gazprom's relatively strong performance and Imperial Energy's losses due to a confrontation with Russia's Natural Resource Ministry. Imperial has fulfilled all of its filing obligations and the charges appear trumped up, but the fund exited the position because of the potential overhang. We have continued to focus on the non-oil parts of the market, adding banks VTB and Sberbank. In Central and Eastern Europe, our zero weight in **Poland** [+2 bps] and **Czech Republic** [+2 bps] provided minor positive contributions while our sole **Hungarian** [-16

bps] position, *Gedeon Richter*, continued to underperform. In the rest of EMEA, **Turkey** [+26 bps] and **South Africa** [+62 bps] were major positive contributors to performance and relative losses occurred in Israel [-12 bp]. In Turkey, core holdings, Migros, and auto producer, Tofas, performed well. In South Africa, our underweight position added value with the market delivering relatively flat returns. During the quarter we initiated a position in Naspers, an emerging market media conglomerate.

**Latin America** produced a very small negative relative performance [-22 bps]. The major markets had virtually no net impact while index lightweight **Peru** [-10 bps] continued to defy gravity with the best GEM market returns. **Brazil's** [+16 bps] market was strong and our slight underweight was offset by positive stock selection. In Brazil, we added to telco competitive exchange carrier, *GVT*, following its March listing on the Novo Mercado and took some profit in *Petrobras* and *Brasil Telecom*. **Mexico** [-12 bps] was a drag on performance and we sold down our stake in *Televisa* ahead of difficult results.

The portfolio continued to struggle in **Asia** [-114 bps], particularly in North East Asia where stock selection has been a drag on performance. In **Korea** [-87 bps], the industrial sector, composed of mostly shipbuilders and construction companies that are benefiting from increasing order books and margin expansion, has been the strongest sector. The fund recently established a position in *Doosan Construction* in June. In **Taiwan** [-21 bps], we have been neutral on the market, but buoyant domestic liquidity, the possibilities of early elections, and corporate expansion in China all contributed to a strong market performance at the end of the quarter and we have been adding to positions. In **China** [-20 bps], stock selection suffered from not having positions in several leading index constituents, including *Petrochina*, *China Life*, and *Sinopec*. We also initiated positions in *Maanshan Iron and Steel*, *Hopson Development*, and *Shanghai Electric*.

**South East Asia** [+18 bps] performance was strong with **Indonesia** [+10 bps] leading and Thailand leading performance [+20 bps]. In Indonesia, we added to our position in coal miner, *Bumi Resources*, during a placement in May. In **Thailand** [+20 bps], solid performance in *Kasikornbank* has contributed to performance. We will look to add positions and are optimistic about the improving political situation with the military appointed government announcing plans to hold a general election before year end. Malaysia [-17 bps] was relatively weak following a strong first quarter. **Philippine** [+5 bps] performance was a mild positive. **Indian** [-33 bps] performance was lackluster due to our longstanding underweight position in the market and weakness in the information technology sector.

## Market Review and Outlook

Emerging markets performed well over the second quarter of 2007. Generally benign economic data, plentiful liquidity, and continuing merger and acquisition activity helped global equity markets move higher whilst the underlying low levels of volatility supported demand for “riskier” assets such as developing equities. The MSCI Emerging Market Index rose by 14.9% over the quarter. These gains comfortably exceeded the returns from developed market equities [+6.5%], emerging debt [-1.6%], and commodity markets [+1.3%] as measured by the Goldman Sachs Commodity Index. Unlike the first quarter of 2007, trading patterns in emerging markets have been relatively calm. Contrast the 11% correction over ten days in March to the past three months which have seen only four days that the emerging market index has declined by more than 1%—the largest fall being just 1.3%.

At the regional level, Latin America [+19.7%] was the best performer with the strongest markets being Peru [+33.6%], Brazil [+23.9%], and Chile [+20.2%]. Asia [+18.4%] finished just behind Latin America due to gains in China [+24.5%], India [+20.8%], and the Philippines [+20.8%]. Subdued performance from stocks in Russia [+0.3%] and South Africa [+2.7%] offset stellar returns from Hungary [+28.7%] and Turkey [+15.4%] and led to EMEA [+5.1%] being the worst-performing region within global emerging markets. Among sectors, industrials [+29.1%], utilities [+20.7%], and materials [+17.2%] outperformed while consumer discretionary [9.3%], health care [10.4%], and information technology [11.2%] lagged.

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For the second successive quarter, Peru [+33.6%] delivered the biggest gain among emerging markets. A 10% rise in copper prices over the quarter fuelled a 32% increase in the share price of Southern Copper. This stock represents just over half of the market capitalization of the MSCI Peru Index. Stock market gains in Brazil [+23.9%] reflected the improvement in economic fundamentals. The central bank cut interest rates to 12% and signaled their intention to lower rates further over the remainder of the year. The bank has now made sixteen straight reductions from September 2005 when interest rates stood at 19.75%. Stocks that are sensitive to growing domestic consumption continued to perform well including the general retailer Lojas Renner [+34%] and the building materials company Duratex [+36.5%]. Stock market returns to foreign investors have also been boosted by strength in the Brazilian currency. The Brazilian real has risen by 10.2% so far this year, the best performer amongst the emerging market currencies. Elsewhere in Latin America, Mexico [+13%] produced another solid quarter as firm economic data in the U.S. continued to support the investment case for the region (80% of Mexican exports go to the U.S.). Domestic stock gains were tempered, however, by a surprise interest rate rise in April—the first increase in over two years. Inflation had been above the central bank's target range of 2–4% in the six months prior to April, which was a key factor in the decision to raise rates by 25 bps to 7.25%. On the corporate front, the mobile phone company America Movil performed well [+29%] following the release of better than expected earnings for the first quarter. Increasing market share has led to 20% and 27% growth in new subscribers in Mexico and Brazil, respectively, for America Movil.

EMEA had a mixed quarter of performance with Russia [+0.3%] providing the lowest returns. The relative risk premium on Russian assets rose after President Valdimir Putin declared staunch opposition towards American plans to place missile defense installations in Eastern Europe. This rhetoric, reminiscent of the cold war, overshadowed healthy fundamentals as the Russian economy expanded by 7.9% in the first quarter—the fastest pace for over six years. South Africa [+2.7%] was another relative laggard over the quarter as inflation and interest rate issues dented investor sentiment. Inflation exceeded the central bank's 3% target range for a second consecutive month in May and this was a major factor for the increase in interest rates by 50 bps to 9.5% in June. This was the first increase in borrowing costs for six months. Stocks within the Gold sector were particularly weak, both Goldfields and Harmony suffering from concern over rising capital expenditure and cash costs of production. Turkey [+15.4%] performed well, particularly in the financial and telecoms sectors. Inflation has been steadily falling (to 8.6% in June) which is fuelling expectations that the central bank will be able to ease monetary policy over the coming months. Interest rates had been increased by 425 bps between June and July of last year and have been steady at 17.5% since then. Hungary [+28.7%] was the best-performing market within the region. The oil refiner Mol accounts for over one third of the market capitalization of Hungary and the stock price rose by 30% over the quarter as OMV of Austria disclosed a 19% shareholding in Mol and requested merger talks. Mol is attempting to counter this approach by initiating a defensive share buy-back program.

China [+24.5%] delivered the highest returns in Asia, driven by gains in the financial, materials, and power sectors. The major economic indicators released during the quarter continued to show an economy growing at a rapid rate. GDP increased by 11.1% in the first quarter whilst investment in fixed assets expanded by 25.9% in the first five months of the year. In response to this data and a surging domestic stock market, interest rates and bank reserve requirements were increased over the quarter whilst domestic share-trading tax was tripled. Chinese companies listed in Hong Kong received a boost following new rules allowing domestic investors to put money into overseas assets under the QDII program [Qualified Domestic Institutional Investor]. South Korea [+18.2%] performed well as global growth conditions boosted sentiment regarding the export sector which makes up over 40% of GDP. Shipbuilders were particularly in demand with Samsung Heavy Industries and Hyundai Heavy Industries recording share price gains of 83% and 86%, respectively, over the quarter. Stock price performance in Taiwan [+14.0%] improved over the quarter as investors began to recognize and exploit the multiple value opportunities within the market. The IT sector constitutes over 60% of the market capitalization of Taiwan and improving sentiment towards this sector aided stocks such as Hon Hi Precision [+28.8%] and Delta Electronics [+21.9%]. Financial stocks were boosted a rise in

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interest rates and the approval of a bill to allow insurers to invest 45% of their assets overseas from the current limit of 35%.

In South East Asia, there was good performance from the Philippines [+20.8%], which reflected a steady improvement in economic fundamentals. Record levels of remittances from workers abroad is contributing to buoyant money supply growth (+21.1% annual growth in May) and aiding structural growth in domestic consumption. Stocks in Thailand [+17.9%] enjoyed a better quarter as positive economic and political developments provided a catalyst for many cheap stocks to re-rate. Interest rates were reduced for the fourth time this year to encourage spending and consumption by the private sector whilst the military appointed government announced plans to hold a general election on November 25. Slowing inflation helped the central bank cut interest rates to 8.5%—the thirteenth consecutive reduction since May of last year. Bank Mandiri [+25%] was a strong performer after reporting a doubling of profits in the first quarter. This outcome was significantly ahead of market expectations.

India [+20.8%] rebounded in the second quarter, aided by a strong rupee, which has risen by 9.5% against the U.S. dollar since mid-March. Quarterly financial results were generally in line, aside from exporters hurt by the exchange rate. The government relaxed its stance on cement price controls, only to apply further pressure on steel prices. Two large placings were oversubscribed: property developer DLF raised \$2.3B in an IPO and ICICI Bank's secondary placing raised \$5B, boosting confidence to the broader Indian market.

After four consecutive months of returns in excess of 4%, a near-term pullback in emerging markets would not be surprising. The asset class is trading at 2.7x price-to-book value. This level is plus one standard deviation higher than the ten-year trend and now at a slight premium to developed markets. This valuation situation mirrors that of March 2006, which precipitated a sharp reversal in emerging equity performance. These are the only two occasions over the past twelve years where emerging markets have traded above developed markets on this valuation ratio. Emerging stocks look vulnerable, therefore, to any rise in risk aversion with the current trend in oil prices being of particular concern. Barring a hard landing scenario in the U.S., we expect corrections to be relatively short-lived as the fundamental and secular pillars for emerging market growth remain secure.

The portfolio continues to be driven by the valuation and fundamental principles of our bottom-up process. The aggregation of our results leads to a preference for many Asian stocks over their counterparts in Latin America and EMEA. We have reinforced our overweight stance in Taiwan (where 58% of companies are cheap according to our database methodology) and continue to favor stocks in Indonesia, Thailand, and the Philippines (63%, 70%, and 80% of stocks are cheap, respectively). Both Korea and China are weighted moderately ahead of the benchmark. Outside Asia, key overweight positions are in Turkey (63% stocks cheap) and Russia (ex-energy stocks). Markets where value is (or is becoming) more difficult to locate include India (40% stocks cheap), South Africa (43% stocks cheap), and Brazil (44% stocks cheap). We retain an underweight policy in both India and South Africa and have used Brazil as a source of funding for new ideas which has resulted in the portfolio weight moving back close to an index weight. In terms of sectors, we are overweight technology, financials, and telecoms and underweight materials and industrials.

**Please note:**

All benchmarks reported are USD performance of the MSCI country price indexes.  
Source Bloomberg.

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Forward Global Emerging Markets Fund—Top Ten holdings as of 06/30/07:

<b>Top Ten Holdings</b>	<b>% Fund with Cash</b>
Petroleo Brasileiro SA, ADR	3.46%
Cia Vale do Rio Doce	3.07%
China Mobile, Ltd.	2.64%
America Movil SA de CV, ADR, Series L	2.57%
Hon Hai Precision Industry Co., Ltd.	2.50%
Samsung Electronics Co., Ltd.	2.35%
OAO Gazprom, Sponsored ADR	2.27%
China Construction Bank Corp.	2.21%
Teva Pharmaceutical Industries, Ltd. Sponsored ADR	1.80%
CNOOC, Ltd.	1.76%

These holdings may not reflect the current or future positions in the portfolio. Portfolio holdings are subject to change.

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. The index figures do not reflect any deduction for fees, expenses or taxes. It is not possible to invest directly in an index.

**Investing in foreign securities will involve certain additional risks, including exchange rate fluctuation, less liquidity, greater volatility, and less regulation. Small company stocks are generally riskier than large company stocks due to greater volatility and less liquidity.**

*You should consider the investment objectives, risks, charges and expenses carefully before investing. A prospectus with this and other information about the Fund may be obtained by calling (800) 999-6809 or by downloading one from [www.forwardfunds.com](http://www.forwardfunds.com). It should be read carefully before investing.*

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