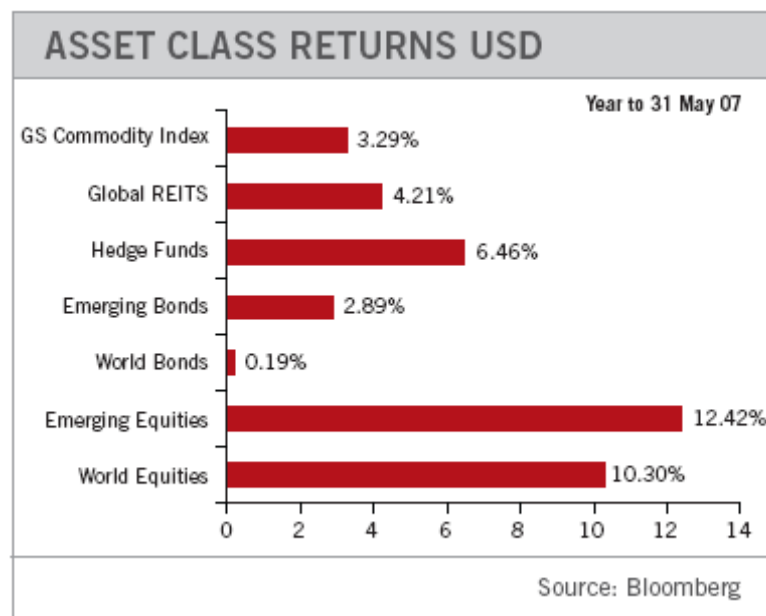
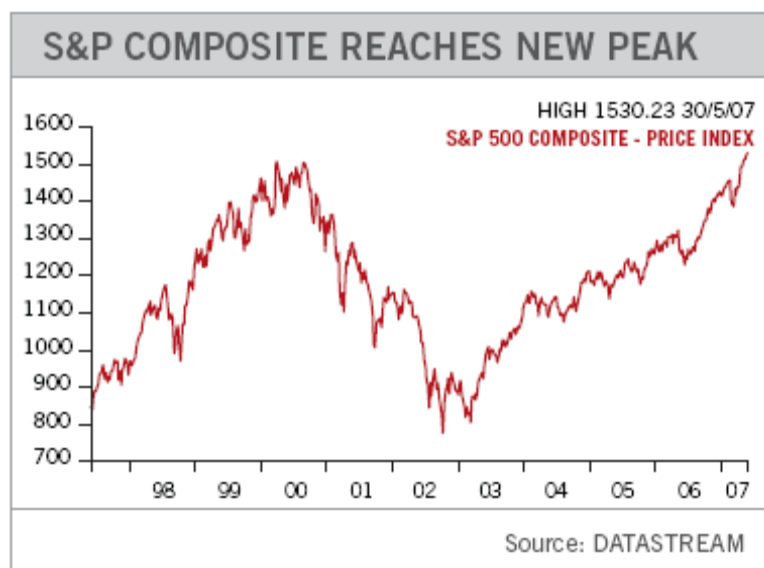


With strong U.S. earnings continuing and valuations generally still favoring equities over bonds, high volatility in Chinese equity markets have so far been brushed off. Reports of governments in China, Russia and elsewhere planning to deploy huge foreign exchange reserves in equity markets and the M&A frenzy undiminished, stocks worldwide seem set to go higher, although rising bond yields may well result in higher volatility in the short term.

The global equity boom continued in May as generally benign economic data, plentiful liquidity and M&A activity provided further lifeblood for the markets' advance. The MSCI World Index rose by 2.9 per cent in U.S. dollar terms, led among developed markets by the U.S., which gained 3.5 per cent. Both the Dow Jones and then the S&P 500 Composite established new all-time peaks.



The broadly based S&P 500 Composite has only just overhauled its previous peak reached during the millennial dot-com bubble seven years ago. Its sector make-up has changed radically since then. At its height, the IT sector accounted for 34.5 per cent of the index against only 15 per cent currently; Cisco Systems, then the largest constituent, has been supplanted by ExxonMobil. The current market advance has been driven by earnings growth rather than by the expansion of P/E multiples, which suggests much firmer foundations at the current level.



In emerging markets, the picture has been rather mixed and, although the MSCI EM Index gained 4.9 per cent, there were sharp divergences in regional returns. The LATAM markets gained 10.6 per cent as Brazil rose 11.7 per cent, reflecting further declines in interest rates, taking debt spreads below the average for emerging markets. MSCI EM Europe, Middle East and Africa fell by 4.6 per cent, led by Russia's 6.7 per cent fall, against a background of growing political tension with the U.S. and Europe. But it was the Chinese market that took center stage as local investors poured into the Shanghai and Shenzhen exchanges in an increasing frenzy of speculation. The Shanghai Composite Index has risen by 144 per cent over the past twelve months, and by 54 per cent since the start of the year, even after a sharp sell-off at month end as the Chinese government attempted to rein in investor enthusiasm by increasing stamp duty on share transactions.

The Chinese authorities have grown increasingly concerned at the rampant growth in speculative activity by retail investors who have pushed up valuations to extreme heights. At these levels, it is confidence rather than fundamentals that keep the bubble intact. Its underpinnings are easy to identify: a decade of strong growth in China has increased cash holdings for many people and a shortage of domestic bonds, together with mostly negative real interest rates, means that there are few homes for the excess domestic liquidity. Capital controls have prevented investment abroad, while the central bank has been forced to buy foreign currency with domestic renminbi to preserve China's fixed exchange rate policy. This domestic currency ultimately finds its way back into the commercial banking system and unless the bank sterilizes these funds through bond issuance, the money supply expands rapidly. Effective sterilization has become harder given the huge sums involved and with banks eager to lend, this excess liquidity has found a natural home in the local equity market.

Partly to ease liquidity pressures, the Chinese authorities have begun to liberalize overseas investment rules. Changes announced in May will allow Chinese bank clients to access foreign equity funds authorized by the Hong Kong Securities and Futures Commission regulator. This move follows the approval last year of the QDII (Qualified Domestic Institutional Investor) scheme, which permits Chinese banks and fund managers access to foreign markets. This of

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course will have little short-term impact on the current local market bubble, which look set to inflate further, unless domestic investors unexpectedly lose their appetite for speculation.



Chinese capital has also been participating in that other engine of the market boom: M&A activity. China's proposed 9.9 per cent, USD 3B investment in the Blackstone private equity partnership has enabled the owners to nearly double the size of the proposed listing of USD 7.8B, making it the second largest IPO this year. Perhaps more importantly, it signaled the intention of the country with the world's largest foreign exchange reserves to invest in risk assets. Elsewhere, the takeover frenzy continued as Alcoa launched a USD 33B hostile bid for Alcan in an attempt to forge the world's largest aluminum group. With News Corp making an unsolicited approach for Dow Jones, Thompson Financial confirming a USD 17B offer for Reuters, and Daimler-Chrysler selling Chrysler to the Cerberus private equity group, markets have continued to feast on the ready supply of available liquidity.

Outlook

Although U.S. GDP was revised downwards to just 0.6 per cent in the first quarter, there is a growing view that this represents a trough. In particular, lower inventories accounted for much of the reduction, while consumer activity stayed firm despite the housing slowdown. The likelihood of stronger growth ahead has been reflected in both the commodity markets, where the price of West Texas oil closed at USD 65 per barrel at month end and in the bond markets. Bond prices have been weakening this year as yields rise in the light of strong global growth and U.S. ten year yields closed at 4.90 per cent in May, up from 4.63 per cent in April.

Asset Allocation

The last three months particularly have seen bond and equity performance diverge as equities have ridden the liquidity wave while bonds have reflected the inflationary potential of vigorous global growth. Despite the growing divergence in performance, equities remain the asset class of choice and we retain our overweight position.

Regional Allocation

The relatively strong performance of U.S. equities in May looks set to persist as expectations of further steady earnings growth ahead are accounted for in share prices. Reasonable valuation levels

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will continue to attract M&A buyers in this and other markets, as companies attempt to establish global platforms for future growth. We remain overweight in Japan and underweight in Europe and Asia.

Sector Allocation

We are not making any changes to sector allocation and retain overweight positions in Healthcare, IT, Financials, Industrials and Consumer Discretionary stocks. We are underweight in Materials, Utilities, Energy and Consumer Staples.

MODEL PORTFOLIO ALLOCATION (%)			
June 07	Benchmark* End April 07	PAM Relative Weight	June 07 v May 07 Change in Recommended Weight
BALANCED			
Bonds	50.0	-15	-
Equities	50.0	+15	-
Cash	0.0	=	-
	100.0		-
REGIONAL EQUITY			
North America	51.2	++	-
Europe	34.0	--	-
Japan	10.5	+	-
Pacific ex-Japan	4.4	-	-
	100.0		
SECTOR EQUITY			
Energy	9.1	-	-
Materials	6.3	--	-
Industrials	10.9	+	-
Consumer Discretionary	11.3	+	-
Consumer Staples	8.3	-	-
Health Care	9.0	++	-
Financials	25.9	+	-
Information Technology	10.1	+	-
Telecoms	4.6	=	-
Utilities	4.5	--	-
	100.0		

* all regional and sector benchmark weights based on MSCI World Index in USD

Foreign securities generally involve additional risks including social and political instability, liquidity, greater volatility and less regulation.

The MSCI World Index is a free float-adjusted market capitalization weighted index designed to measure equity market performance of developed markets.

The Dow Jones Industrial Average is a price-weighted average of 30 actively traded blue chip stocks, primarily industrials.

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The S&P 500 Composite is a market value-weighted index of 500 stocks chosen for market size, liquidity and industry group representation. It is one of the most widely used benchmarks of U.S. stock performance.

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index designed to measure equity market performance of emerging markets.

MSCI EM Europe, Middle East and Africa Index is a free float-adjusted market capitalization weighted index designed to measure the equity market performance of the emerging market countries of Europe, the Middle East & Africa.

The Shanghai Composite Index is an index of all stocks (A shares and B shares) traded on the Shanghai Stock Exchange.

It is not possible to invest directly in an index.

You should consider the investment objectives, risks, charges and expenses of the Forward Funds carefully before investing. You may obtain a prospectus with this and other information about the Funds by calling (888) 312-4100 for a prospectus or by downloading one at www.forwardfunds.com. Please read the prospectus carefully before investing.

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