Fund Commentary

Forward Emerald Banking and Finance Fund
Market Review and Outlook
First Quarter 2007

By the end of the first quarter the yield curve spread between the two-year and the 10-year started to see some positive slope, which is clearly a positive for the banks. While the entire curve is not positively sloped, the two and 10-year spread was a positive seven bps at quarter end. We hope to see further steepness in the slope, which may result from a cut by the Fed later this year. If the Fed were to cut rates by even 25 bps, we may see bank stocks rally. While the fundamentals of the industry are clearly not favorable at the moment, we could see a return to healthier valuations brought on by a rate cut or continued strength in the M&A market.

Credit has been a very recent and key concern of the market brought on by the sub-prime market implosion. Credit has always been the utmost concern to Emerald as we evaluate our investments and our exposure to the sub-prime market is minimal. We do not own any banks that focus on sub-prime or have a substantial portion of sub-prime on their books. From time to time a bank may make CRA loans (under the Community Reinvestment Act) or have some exposure to those that do not have the best credit. However, under the CRA, banks are required by the government to offer loans to underserved people in their community in order that they can afford housing and to small businesses in order that they can afford commercial loans. The government expects that banks will be an aid to those in need and will make several of these loans. This is not true sub-prime lending. Our banks are not making loans for the sake of growing their balance sheets and blindly accepting higher risks. We invest in banks that focus on maintaining a high quality portfolio and do not make unnecessary loans for the sake of growth. We have no evidence that our community banks are bending their underwriting standards. Community banks understand that asset quality is the key to a solid banking institution and nothing can hurt more than a fundamental deterioration in credit.

Margin pressure continues to remain an industry wide issue as competition for deposits and loans remains strong and the yield curve remains relatively flat. If we see further improvement in the curve and if we see competition subside, margin pressure should substantially subside or possibly be eliminated by 2Q07. Our channel checks indicate that we may be at or close to the bottom of compressing margins. Deposit pricing in aggregate has eased a little, but loan pricing remains very competitive and will continue to be a downward pressure on margins. Having said that, we have been adamant about holding commercial focused banks rather than consumer and retail focused banks. This has led to relatively stable net interest margins of Emerald banks compared to the more significant industry wide compression. In the current environment, with rates holding steady, we have seen the benefit of low cost funding from commercial deposits alleviate some of the pricing pressure and keep margins of commercial banks relatively steady.

Bank & Thrift acquisition activity has been robust. The total number of deals posted so far in 2007 indicates a stronger pace than 2006, which was a record year itself, posting the highest number of deals since 1999. The macro environment for further activity is very favorable. The competitive environment is fierce, the yield curve (2/10) is relatively flat, and management teams are getting tired of facing an uphill battle. We believe there are more potential sellers in this environment than there have been for some time.

We own banks in many key M&A states that are able to take advantage of the dislocation caused by the acquisitions in their respective markets. We remain optimistic that deal activity will continue to be strong against the backdrop of a tougher environment and that activity will continue to provide banks with opportunities to pick up market share through acquisition of dislocated customers and the hiring of key employees to grow the bottom line.

We believe that banks with a defined niche, such as those that are focused on serving the growing Asian segments of the U.S. population will be big beneficiaries of improved valuations once banks come back into favor. Both growth and asset quality are strong for these Asian-focused banks compared to the general banking industry. Koreans, Chinese, and other groups emigrating into the U.S. from Asia have increased substantially over the last decade and are expected to continue growing at similar rates for at least the next decade. Our holdings include East West Bancorp (EWBC), MetroCorp Bancshares (MCBI), Preferred Bank (PFBC), and Wilshire Bancorp (WIBC).

Our belief that community banks will continue to be a good place to invest is based on the underlying strengths of this sector. Small cap banks boast stronger revenue growth, higher net interest margins, and stronger balance sheet growth than their large cap counterparts. Community banks offer excellent competitive advantages to their bigger peers. Some of these advantages are:

1) Better customer service – This is the best advantage a community bank has over a bigger bank. Employees at all levels of the bank know their customers by name and make sure they receive the best service possible. As technology continues to be an even greater part of our lives, personal service will never be replaced; people like to be known by name rather than their checking account number.
2) Strong asset quality – The personal service translates into better underwriting. Community bank lenders know their customers on a more personal level than a big bank can. This relationship between the community bank lender and the customer gives the lender a better understanding of the business, which translates into stronger underwriting.
3) Stable loan growth – Not only does the community bank benefit from the natural business growth in its market, it is also well positioned to pick up additional loans from big bank customers that are not getting the customer service that they demand.
4) Higher net interest margins – Big banks attract customers by offering low rates on loans and high rates on deposits. Community banks do not have to be as competitively priced due to their better customer service. Higher margins translate into a stronger bottom line.

The Bank Fund’s performance was positively impacted by several non-bank companies. Hub International (HBG), an insurance broker, is one of the best in the space and was a strong fundamental performer. In addition to strong performance, the company was acquired for a premium during the quarter. Highland Hospitality (HIH), a hotel REIT, was a strong contributor to performance as the upscale hotel REIT space remains healthy. Additionally, Highland is very bullish on future growth prospects. KBW (KBW) did well due to strong 4Q results. The M&A and investment banking landscape for banks and thrifts remains very favorable and we believe this company will continue to benefit from that. Our best performing bank was Virginia Commerce (VCBI), which continues to be a fast growing bank in the northern Virginia market with a very strong credit portfolio. It had previously been an underperformer due to some one time issues in the third quarter that have since been resolved.

Our worst underperforming stocks included two P&C insurance companies, United America Indemnity (INDM) and Selective Insurance Group (SIGI), as well as several banks. The operating environment for P&C insurance companies is also very tough given minimal premium growth and soft pricing. We believe the valuation on INDM is attractive here and that the company fundamentals are relatively favorable. However, there have been some management issues which have kept the stock from performing. Regarding Selective's performance, the stock did not do well after the Q4 earnings release which showed a contraction in premiums for the first time and gave lower '07 guidance. While the environment will continue to be tough moving forward, we believe the valuation and the stock buyback that are in place support more upside than downside at this point. Ultimately, the underwriting profitability and the revenue growth are still in place.

We believe that the P&C insurance market will continue to provide select opportunities for investment. Pricing continues to soften. However, our insurance holdings are smaller companies with a product niche or a service niche that allows them to have a little more flexibility in their pricing and be able to underwrite business more profitably.

We still believe that apartment REITs continue to remain an attractive investment as the housing market remains in a slump and the affordability gap between homeownership and renting remains significant. That gap also provides strong support for additional rate increases for apartments. Strong job creation and the contraction of new home construction are also big positives for the sector. We believe this sector will continue to outperform in the next 12-18 months driven by rate increases and strong economic support. One of our better performing stocks during the quarter was an apartment REIT, America First Apartment Investors (APRO). Other REIT sectors also remain attractive such as campus housing and hotels.

Several brokerage, exchange, and options clearing businesses remain attractive in this environment. E*Trade (ET) remains one of our favorite names in the brokerage space because of its unique model. Penson Worldwide (PNSN) is a great growth name focused on offering an array of securities processing infrastructure products and services to the securities and investment industry. They continue to deliver on their goals and have quickly become a unique and recognized way to gain exposure to the securities/exchange market. WisdomTree Investment (WSDT.PK) is the only pure way to play the fast-growing ETF market. They offer 30 dividend-weighted ETFs in addition to 6 earnings-weighted ETFs and have seen tremendous demand for their products which has caused assets to grow substantially. Additionally, Chairman Michael Steinhardt and Professor Jeremy Siegel are at the heart of the company. Steinhardt alone owns about 1/3 of the company.

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. It should be read carefully before investing.

Funds that concentrate in a particular industry will involve a greater degree of risk than a fund with a more diversified portfolio. There are risks involved with investing, including loss of principal. Past performance does not guarantee future results.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index. The Russell 3000 Index represents approximately 98% of the investable U.S. equity market. The index figures do not reflect any deduction for fees, expenses or taxes. It is not possible to invest directly in an index.

As of March 31, 2007, the Fund held the following positions in the portfolio:

East West Bancorp (EWBC) – 1.65%; MetroCorp Bancshares (MCBI) – 0.40%; Preferred Bank (PFBC) – 2.46%; Wilshire Bancorp (WIBC) – 1.74%; Hub International (HBG) – 2.78%; Highland Hospitality (HIH) – 0.55%; KBW (KBW) – 0.63%; Virginia Commerce (VCBI) – 2.10%; United America Indemnity (INDM) – 2.34%; Selective Insurance Group (SIGI) – 1.33%; America First Apartment Investors (APRO) – 0.69% E*Trade (ET) – 1.71%; Penson Worldwide (PNSN) – 0.70%; WisdomTree Investment (WSDT.PK) – 0.62%

These allocations may not reflect the current or future positions in the portfolio.

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