Fund Commentary

Forward International Small Companies Fund
Market Review
Second Quarter 2007

Average annual returns as of 06/30/07	1YR	3YR	5YR	10YR	Since Inception (02/07/96)
Forward International Small Companies Fund— Institutional Share Class	29.23%	28.66%	25.72%	15.74%	14.52%
HSBC World ex-U.S. Smaller Companies Index	30.91%	28.11%	27.55%	11.51%	10.98%
MSCI EAFE Small Cap Index	25.59%	25.24%	24.78%	9.71%	8.45%

	Gross Expense	Net/Actual Expense
Forward International Small Companies Fund (Institutional Share Class)	1.28%	1.25%

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.

Market Review

Markets advanced modestly in the second quarter, maintaining the positive momentum of returns, particularly those expressed in U.S. dollars. Small caps did lag their smaller peers slightly over the period, but this was only by around 2% when comparing the returns of the respective MSCI World-ex U.S. Developed markets indexes.

The pattern in small caps was similar to that in larger markets, that is, Asia was especially strong, (in local currency terms) as were most European markets, with the standout laggard being Japan. Here the market still struggles from the fallout of the Livedoor accounting shock of early last year, but also consumption and profit growth have both consistently disappointed expectations.

The Fund has performed in-line with the benchmark over the quarter under review, with both rising by 4.2%. The best relative contribution came from Continental Europe, where stock selection was highly beneficial, and which outweighed slightly negative contributions elsewhere.

Economic Background

Reshuffling of asset allocations in favor of equities or credit-risk instruments continued to penalize

government bonds in June. With growth in Europe being confirmed as likely to last longer than expected, and with the rebound in the USA set to come more quickly than anticipated (which rekindled all sorts of worries about inflation), coupled with hawkish comments from the world's central banks, the rise in bond yields gained momentum and yield curves steepened quite noticeably as longer-dated maturities were the hardest hit.

Hopes of the Fed funds rate being cut not only evaporated into thin air, but the markets even began to be concerned about a resumption of rate hikes. In Europe, expectations about rising rates hardened considerably. Markets are now expecting that, by the end of this year, the European Central Bank (ECB)'s repo rate will be up at 4.50% and the Bank of England's base rate at 6.0%.

GDP growth in the USA, already stronger than anticipated, is likely to bounce upwards in the second quarter, to around +3%. This upswing, however, can be put down to inventory levels being readjusted and buoyant foreign trade. Moreover, as the Fed has been at pains to point out, events on the housing front are likely to continue exerting a negative impact. Furthermore, consumer spending may well be curbed by rebounding oil prices and the likelihood of the jobs market being a little less upbeat in future. Thus, growth may still come in close to consensus forecasts for this year. Europe's economy is expanding above its potential, with Germany, in particular, regaining momentum. Investors have jettisoned the scenario of a slowdown ahead. Lastly, the economic news flow for Japan, China, and India is still delivering positive readings.

Inflation is likely to stay subdued everywhere although the outlook is still fairly unsettled, as central banks worldwide are constantly reminding us. In the circumstances, it seems likely that the Fed is likely to keep the Fed funds rate on "hold." There seems very little chance of the Fed funds rate being cut as inflationary risks have not been dispelled altogether, capacity utilization rates are running high, productivity gains are less than impressive, and unit labor costs are on the up. The Fed might even take a step to lift the rate if the upswing in the U.S. economy were to be sustained.

The ECB will probably press ahead with tightening monetary screws in its belief that its monetary policy remains accommodating. Even though inflation is pitched a touch below its official target, a close eye will need to be kept on the vigor of the euro-zone economy, strong growth in M3* and bank lending, and the rising prices for some assets so the ECB can be expected, in all probability, to hike its repo rate to 4.50% before the year is out. Lastly, the Bank of Japan may well raise interest rates once elections are out of the way.

Japan's GDP advanced by 0.8% q-o-q in the opening quarter this year, slightly faster than the 0.6% suggested by preliminary estimates. A noticeable revision to statistics for private-sector investment was the main reason for the upgrade: after a drop of 0.9% being recorded according to initial estimates, it actually registered a 0.3% rise.

Exports, posting q-o-q growth again, generated a positive contribution to the economy (+0.4%) and should remain fairly dynamic, benefiting from brisk economic growth in the rest of Asia, especially in China. Activity indexes for the tertiary sector and for industry as a whole bounced back up in April, as did private-sector orders for machinery. Overall, recent statistics have been consistent with growth continuing to run at roughly 2.3%, as the consensus is projecting. The headline rate of inflation, which had stayed stuck in negative territory in the last two months, finally climbed back up to 0% y-o-y in May. If fresh food prices are stripped out, the rate of inflation rose from –0.3% to –0.1%; if oil product prices are taken out, it climbed from -0.4% to –0.2%.

Portfolio Strategy

The U.S. economy appears to be experiencing a mid-cycle correction and sharply higher borrowing costs will further undermine the housing market and the ability of consumers to continue to spend. Thus, any significant slowing in activity will be met by lower bond yields which will act to reinforce economic activity. This suggests that the more usual relationship between the economic cycle and

interest rates may be re-asserting itself and that Greenspan's bond market conundrum of buoyant growth and ever-lower yields is fading away.

In economic terms, growth currently seems to be well underpinned. In the U.S., employment remains solid and the ISM survey rose to a 13-month high in May. Housing, though, remains weak and could yet feed through into lower consumption, as petrol prices and interest rates squeeze household spending power. In the euro zone, 2006 showed the fastest GDP growth in six years. Business borrowing remains strong and the ECB have increased interest rates for the eighth time since December 2005, to 4%. Japan's economy grew at an annual rate of 3.3% in the first quarter and this rate of growth has heightened expectations that interest rates will be raised this summer.

Our strategy remains little changed over the quarter. We have reduced our weight somewhat in Japan, as economic profits consistently disappointed, to a neutral position. Conversely, we reduced our U.K. underweight in the face of an exceptional liquidity environment and frenetic M&A activity, which has impacted several of our holdings to beneficial effect. As mentioned before, we are bullish on the prospects for European markets due to the improved economic background, M&A activity, and corporate restructuring. We also maintain our long-time overweight in the Asia Pacific region, where economic growth has consistently surprised on the upside, and local asset price reflation is strong. We had reduced cyclical stocks (mainly energy and resources) over the course of the first quarter, and there has been little change in our style allocation since then.

*M3 is a broad measure of money used by economists to estimate the entire supply of money within an economy. It includes: physical currency (including accounts that can be exchanged for physical currency); currency held as reserves or vault cash; currency held in demand accounts, savings accounts, money market accounts, small denomination time deposits, and certificates of deposit accounts; as well as all large-time deposits, institutional money-market funds, short-term repurchase agreements, among other larger liquid assets.

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.

Investing in foreign securities generally 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. There are risks involved with investing, including loss of principal. Past performance does not guarantee future results.

The HSBC World ex-U.S. Smaller Companies Index is a market capitalization weighted index designed to represent performance of smaller companies available in developed stock markets outside the United States and Canada. The index figures do not reflect any deduction for fees, expenses, or taxes. It is not possible to invest directly in an index.

The MSCI EAFE Small Cap Index is an unmanaged, market-weighted index of small companies in developed markets, excluding the U.S. and Canada. The index figures do not reflect any deduction for fees, expenses or taxes. It is not possible to invest directly in an index.

The MSCI World Index ex-U.S. is a free float-adjusted market capitalization index that is designed to measure global developed market equity performance.

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