

## REIT Preferred Securities Historical Spread to the 10-Year Treasury

### Where are spreads today?<sup>1</sup>

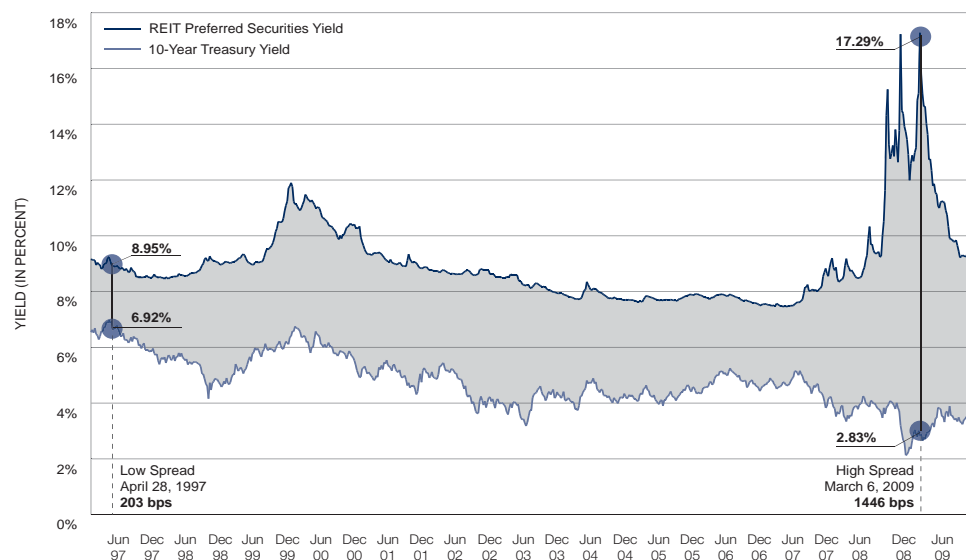
How depressed REIT preferred stocks had become earlier this year is highlighted by the fact that, despite robust price appreciation in 2009, the yield spread between REIT preferred securities and the 10-Year Treasury remains relatively wide.

The current spread of 605 basis points (as of November 30, 2009) is still high when compared to a long term average spread of 430 basis points.

As shown in the chart below, the yield spread was at its narrowest in late April 1997 at 203 basis points and hit a historic high of nearly 1,450 basis points in early March 2009. We would note that the long term average spread of 429 basis points includes the recent “crisis level” spreads, which were well over 1,000 basis points.

**REIT Preferred Securities vs. 10-Year U.S. Treasury Index<sup>2</sup>**

January 6, 1997 – November 30, 2009



Source: Wells Fargo Securities, Bloomberg and Forward Management, LLC. The REIT Preferred Securities Yield is measured for all periods after October 28, 2002 by the Wells Fargo® Hybrid and Preferred Securities REIT Index, primarily based on weekly data. Please see footnote 2 on the reverse of this page for more important information.

**Past performance is not indicative of future results.**

### What does this mean for REIT preferreds?

While visibility on common stock dividends in the REIT space continues to be somewhat limited, the senior position offered by preferred securities provided insulation against dividend omissions. Since most preferred dividends are cumulative, meaning that the issuer must accrue any missed dividend as a liability and eventually pay it, preferred cash flows are typically more stable than their common stock counterparts. Similarly, the default rate on preferred stocks is typically low, and usually measures well below defaults on high-yield bonds.

We believe that REIT preferred securities spreads will continue to move back toward their long term historical averages over time. With a strip yield of nearly 10% and a 600+ basis point spread over 10-year treasuries, holders of these securities have the potential for capital appreciation with attractive dividend yields along the way.

**But how will the spread narrow?** We believe there are two options:

TREASURY RATES  
INCREASING

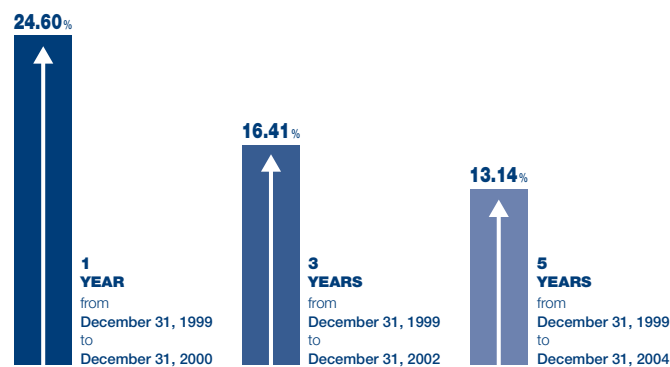
Treasury rates are at relatively low levels. With the credit crisis, housing downturn and high unemployment serving as strong deflationary drivers, it seems unlikely there will be much upward pressure on interest rates in the near term. However, should rates rise, we believe the current wide spread would serve to minimize downside risk.

PREFERRED YIELDS  
FALLING

Absent an increase in Treasury rates, investors may benefit from higher returns should REIT preferred prices increase.

Interestingly, after a period of relatively wide spreads in 1999, REIT preferred securities delivered positive returns each year until 2004. The table below demonstrates the returns that followed this period of wide spreads:

**REIT Preferred Returns After December 31, 1999**



Source: Zephyr Associates, Inc. Performance measured by the Merrill Lynch REIT Preferred Index. **Past performance is not indicative of future results.**

While the chart above shows robust returns, it is worth noting that these returns were generated during a period of declining Treasury yields and increasing REIT preferred prices. From December 1999 to June 2003, Treasury yields declined nearly 300 bps (from 6.28% to 3.33%).

## Outlook

The real estate business is likely to face challenges in the months ahead—primarily from decreasing occupancy and rent levels. The challenge is on for real estate operators to stay full and to retain tenants as well as talented personnel. We expect continued news flow about challenges in the real estate business.

We believe REITs will fare relatively well in this environment. In our view the listed, public REITs have—by raising equity and debt capital—put themselves in an improved position relative to their privately-held peers. While we expect periods of volatility in the months ahead, we firmly believe REITs are positioned to grow and prosper as the economy and the property markets recover.

As REIT stock values improve, yield compression is expected. We believe senior securities will continue to deliver attractive dividends with less risk and more stability than common stock and high-yield bond alternatives. Our focus on well-managed companies with strong balance sheets and our judicious use of leverage should deliver steady income with the potential for moderate capital growth.

*Please consider the investment objectives, risks, charges and expenses carefully before investing in the fund. A prospectus with this and other information about the fund may be obtained by calling (888) 312-4100 or by downloading one from [www.forwardfunds.com](http://www.forwardfunds.com). It should be read carefully before investing.*

The Forward Select Income Fund seeks high current income and the potential for modest long term growth of capital.

**The Fund will invest in lower-rated debt securities and may utilize derivatives for hedging purposes. The Fund's use of short selling and derivatives involves additional risks and transaction costs, and creates leverage, which can increase the volatility of the Fund. The use of derivatives may also reduce performance. The Fund may invest a larger percentage of its assets in the securities of a smaller number of issuers, since it is a "non-diversified" mutual fund.**

<sup>1</sup> "Spread" is the difference in yield between two different investments. In this example, we use "spread" to refer to the difference between the yield offered by REIT preferred issues and the 10-year Treasury rate. The price of yield-oriented investments is based on both credit quality and spread (the current price moves inversely to the yield). A wide spread-to-Treasury typically indicates more attractive relative pricing.

<sup>2</sup> In order to achieve the longest possible time series, this chart is created using two data sources to calculate the spread. The data set is generally weekly data with some daily data. The source for data from January 1, 1997 through October 28, 2002 is Forward Management and is based on an examination of all real estate companies (including, but not limited to, REITs) and excluding mortgage companies. Data for all periods thereafter is from the Wells Fargo<sup>®</sup> Hybrid and Preferred Securities REIT Index, which is an index of preferred stocks issued by REITs (including mortgage companies).

The Wells Fargo<sup>®</sup> Hybrid and Preferred Securities REIT Index is designed to track the performance of preferred securities issued in the US market by Real Estate Investment Trusts. It is a modified market capitalization-weighted index composed exclusively of \$25 par perpetual preferred shares and depositary shares listed and traded on either the New York or American stock exchanges.

The yield for the 10 Year U.S. Treasury Note is an index of constant maturity rates published by the U.S. Department of the Treasury and sourced from Bloomberg. Yields are interpolated by Treasury from the daily yield curve. This curve, which relates the yield on a security to its time to maturity, is based on the closing market bid yields on actively traded Treasury securities in the over-the-counter market. These market yields are calculated from composites of quotations obtained by the Federal Reserve Bank of New York.

The Merrill Lynch REIT Preferred Index is an unmanaged index of investment grade REIT preferred shares with a deal size in excess of \$100 million, weighted by capitalization and considered representative of investment grade preferred real estate stock performance. You cannot invest in an index and many REIT preferred issues are not rated or are below investment grade.

Basis point (bps) is a unit that is equal to 1/100th of 1%, and is used to denote the change in a financial instrument. Cash flow measures the cash generating capability of a company by adding non-cash charges (e.g. depreciation) and interest expense to pretax income. A preferred stock is a class of ownership in a corporation that has a higher claim on the assets and earnings than common stock. Preferred stock generally has a dividend that must be paid out before dividends to common stockholders and the shares usually do not have voting rights.

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