

MUTUAL RECOVERY FUND

AS OF 12/31/13 VALUE

FUND DESCRIPTION

The fund seeks capital appreciation with superior riskadjusted returns and a moderate correlation to the U.S. equity market through opportunistic investments in event-driven situations, including distressed securities, merger arbitrage and undervalued stocks.

FUND DATA¹

Total Net Assets-All Share Classes: \$59.9 million

Number of Holdings: 128

Inception: 6/2/03

Benchmark: S&P 500 Index

Minimum Initial Investment: \$10,000

Symbol by Class:

Α	С	Advisor	
FMRAX	FCMRX	FMRVX	

MAXIMUM SALES CHARGES

Class A: 5.75% initial sales charge

Class C: 1% contingent deferred sales charge

(CDSC) in the first year only

TOTAL ANNUAL OPERATING EXPENSES

Without Waiver²: Class A: 2.83%; Class C: 3.54% With Waiver: Class A: 1.49%; Class C: 2.20%

Performance data represents past performance, which does not guarantee future results. Current performance may differ from figures shown. The fund's investment return and principal value will change with market conditions, and you may have a gain or a loss when you sell your shares. Please call Franklin Templeton Investments at (800) DIAL BEN/342-5236 or visit franklintempleton.com for the most recent month-end performance.

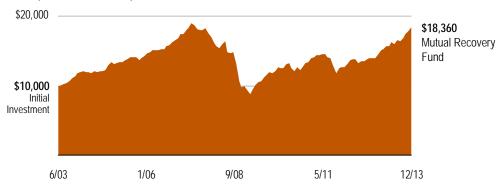
Understanding the Fund's Fulcrum Fee

The fund's management fee, a component of the fund's operating expenses, is set up to reward good relative performance and penalize poor relative performance. Here's how it works:

- The fee will range between 0.5% and 2.5%.
- Each month, the rolling 1-year performance of the fund and the Bloomberg/EFFAS U.S. Government 3–5 Years Total Return Index are compared.
- The fee adjusts up or down by 0.2% for every 1% that the fund's performance exceeds or falls short of the index.

GROWTH OF A \$10,000 INVESTMENT—Class A (Without Sales Charge)3

June 2, 2003-December 31, 2013



If the sales charge had been included, the return would have been lower.

AVERAGE ANNUAL TOTAL RETURNS (As of December 31, 2013)

With Maximum Sales Charges⁴

Class	Inception Date	1 Yr	5 Yrs	10 Yrs	Since Inception
Α	6/2/03	18.85%	11.74%	3.93%	5.32%
С	6/2/03	24.22%	12.30%	3.86%	5.22%

Without Sales Charges³

1 Yr	5 Yrs	10 Yrs	Since Inception
26.10%	13.07%	4.54%	5.91%
25.22%	12.30%	3.86%	5.22%

PORTFOLIO BREAKDOWN^{1,5}



TOP 10 HOLDINGS¹

Deepocean Group Holding BV	. 4.42%
Vodafone Group PLC	. 4.32%
Lehman Brothers Holdings Inc	. 4.06%
Clear Channel Communications Inc	. 3.62%
Tribune Co/New	. 3.23%

- 1. As of 12/31/13. Holdings are subject to change. For updated information, please call Franklin Templeton Investments at (800) DIAL BEN/342-5236 or visit franklintempleton.com. The portfolio manager for the fund reserves the right to withhold release of information with respect to holdings that would otherwise be included in the holdings list(s).
- 2. The fund has an expense reduction contractually guaranteed through at least July 31, 2014. The fund may also have a fee waiver associated with any investments it makes in a Franklin Templeton money fund, an arrangement that is contractually guaranteed through at least its current fiscal year end. Fund investment results reflect the expense reduction and fee waiver, as applicable; without these reductions, the results would have been lower.
- 3. Figures include the Rule 12b-1 expenses as if in effect during the entire period.
- 4. Prior to 11/3/03, the fund offered only Advisor Class shares, which do not have a sales charge or Rule 12b-1 expenses. The offering of Class A and C shares commenced on 11/3/03. Performance figures reflect a restatement of the Advisor Class performance to include both the Rule 12b-1 fees and sales charges applicable to each share class as though in effect from the fund's inception. For periods after 11/3/03, actual performance is used, reflecting all charges and fees applicable to each share class. Figures assume reinvestment of dividends and capital gains at net asset value. The fund offers other share classes, subject to different fees and expenses, which will affect their performance.

MUTUAL RECOVERY FUND

PORTFOLIO MANAGERS6

Shawn Tumulty

Since 2005; joined Franklin Templeton in 2000

Christian Correa, CFA

Since 2004; joined Franklin Templeton in 2003

Keith Luh, CFA

Since 2009; joined Franklin Templeton in 2005

WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal. The fund may invest in companies engaged in mergers, reorganizations or liquidations, which involve special risks, as pending deals may not be completed on time or on favorable terms, as well as lower-rated bonds, which entail higher credit risk. The fund is a non-diversified fund and may experience increased susceptibility to adverse economic or regulatory developments affecting similar issuers or securities. The fund may invest in foreign securities whose risks include currency fluctuations, and economic and political uncertainties. These and other risks are described more fully in the fund's prospectus.

Investors should carefully consider a fund's investment goals, risks, charges and expenses before investing. To obtain a summary prospectus and/or prospectus, which contains this and other information, talk to your financial advisor, call us at (800) DIAL BEN/342-5236 or visit franklintempleton.com. Please carefully read a prospectus before you invest or send money.

MANAGER'S PERSPECTIVE

"By focusing on asset classes that have historically shown low correlation to equity markets as well as each other, we're able to construct a portfolio that can potentially help investors better diversify their portfolio. Most of the investments we look at are deal specific, so they don't tend to move with the market, but still offer strong return potential. We're willing to dig in deep to find investments that many other managers can't or won't take a look at due to their complexity. Our network of transaction professionals and years of experience working in distressed debt, merger arbitrage and other event-driven securities make Mutual Recovery Fund a unique offering in the crowded world of mutual funds."

-Christian Correa, Portfolio Manager

CALENDAR YEAR TOTAL RETURNS—CLASS A (Without Sales Charge)

2013	2012	2011	2010	2009	2008	2007	2006	2005	2004
26.10%	15.44%	-9.71%	10.31%	27.50%	-41.66%	0.98%	18.59%	6.74%	13.11%

If the sales charge had been included, the returns would have been lower.

STRATEGIC ALLOCATION1

	Percentage	Number of Issuers
Distressed/Post-Reorg	35.87%	29
Merger Arbitrage	3.15%	4
Undervalued Stocks/Other	51.89%	39
Cash	5.20%	-

STATISTICAL ANALYSIS^{7,8}

Mutual Recovery Fund—Class A vs. S&P 500 Index June 2, 2003–December 31, 2013

Risk Analysis	
Standard Deviation ⁹	12.71%
Sharpe Ratio ¹⁰	0.26
Sortino Ratio ¹¹	0.22

0.81
-0.05
0.00
0.00

THE QUARTERLY TENDER OFFER PROCESS

Mutual Recovery Fund is structured as a continuously offered, closed-end investment company due to the relatively illiquid nature of many of the fund's investments. Investors can purchase shares on any day the markets are open, but shares aren't redeemed daily. Instead, Mutual Recovery Fund offers to buy back 5%–25% of the outstanding shares each quarter during the tender offer period. The fund may suspend or postpone a tender offer subject to approval by the fund's board.

- 5. Due to rounding, the sum of portfolio holdings may not equal 100%.
- 6. CFA® and Chartered Financial Analyst® are trademarks owned by CFA Institute.
- 7. Prior to 11/3/03, the fund offered only a single class of shares without a sales charge and Rule 12b-1 expenses, Advisor Class shares. Performance figures reflect a restatement of the Advisor Class performance to include the 12b-1 fees applicable to Class A as though in effect from the fund's inception. For periods after 11/3/03, actual performance is used, reflecting all charges and fees applicable to Class A. Figures assume reinvestment of dividends and capital gains at net asset value.
- 8. All indexes are unmanaged and include reinvested dividends. One cannot invest directly in an index.
- 9. Statistical measurement of the range of a fund's total returns. In general, higher standard deviations means greater volatility.
- 10. Calculated using standard deviation and excess return over that of the three-month Treasury bill. Higher values generally indicate better historical risk-adjusted performance.

- 11. A measurement used to differentiate harmful volatility from volatility in general—a measurement of return per unit of risk on the downside. Calculated by using downside semivariance, which is a measurement of return deviation below a minimal acceptable rate.
- 12. A measure of market risk. Each index is assumed to have a beta of 1.00. The fund's comparative beta, if lower, indicates historically lower volatility; higher than 1.00 indicates higher volatility.
- 13. The annualized percentage difference between a fund's actual returns and its expected performance given its level of market risk, as measured by beta.
- 14. Measures the extent to which the returns of a portfolio and its benchmark are related. 1.00 indicates perfect positive correlation, and -1.00 indicates perfect negative correlation.
- 15. Percentage of the fund's returns explained by movements in the comparative index; 1.00 equals perfect correlation to index movements. Past performance does not guarantee future results.



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