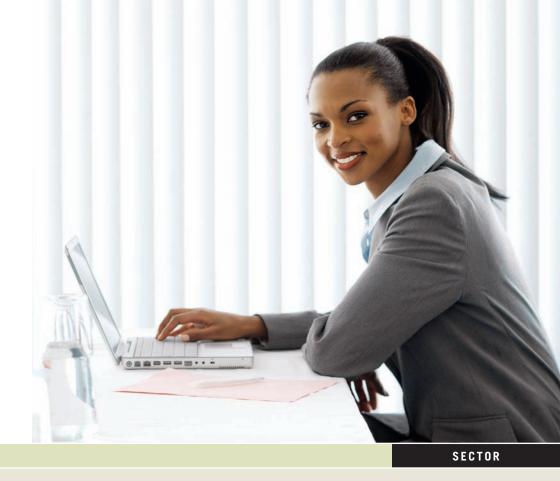
JUNE 30, 2013
SEMIANNUAL REPORT
AND SHAREHOLDER LETTER



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MUTUAL FINANCIAL SERVICES FUND



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Franklin Templeton Investments

Gain From Our Perspective®

Franklin Templeton's distinct multi-manager structure combines the specialized expertise of three world-class investment management groups—Franklin, Templeton and Mutual Series.

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Each of our portfolio management groups operates autonomously, relying on its own research and staying true to the unique investment disciplines that underlie its success.

Franklin. Founded in 1947, Franklin is a recognized leader in fixed income investing and also brings expertise in growth- and value-style U.S. equity investing.

Templeton. Founded in 1940, Templeton pioneered international investing and, in 1954, launched what has become the industry's oldest global fund. Today, with offices in over 25 countries, Templeton offers investors a truly global perspective.

Mutual Series. Founded in 1949, Mutual Series is dedicated to a unique style of value investing, searching aggressively for opportunity among what it believes are undervalued stocks, as well as arbitrage situations and distressed securities.

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Because our management groups work independently and adhere to different investment approaches, Franklin, Templeton and Mutual Series funds typically have distinct portfolios. That's why our funds can be used to build truly diversified allocation plans covering every major asset class.

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At Franklin Templeton Investments, we seek to provide investors with strong risk-adjusted returns over the long term, as well as the reliable, accurate and personal service that has helped us become one of the most trusted names in financial services.

MUTUAL FUNDS | RETIREMENT PLANS | 529 COLLEGE SAVINGS PLANS | SEPARATELY MANAGED ACCOUNTS



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Shareholder Letter

Average Annual Total Return

Class Z	6/30/13
1-Year	+23.74%
5-Year	+3.77%
10-Year	+4.74%

Performance data represent past performance, which does not guarantee future results. Investment return and principal value will fluctuate, and you may have a gain or loss when you sell your shares. Current performance may differ from figures shown. Please visit franklintempleton.com or call (800) 342-5236 for most recent month-end performance.

Dear Mutual Financial Services Fund Shareholder:

In the first half of 2013, financial market performance varied significantly across the globe and among various asset classes. Equity markets in the U.S. continued their strong rise, but European and Asian markets (excluding Japan) trailed. Credit markets have benefited from a low interest rate environment and government liquidity stimuli designed to improve anemic economic growth in developed economies. However, these markets finally began to cool amid talk of a tapering of the Federal Reserve Board's (Fed's) quantitative easing (QE) programs. Mutual Financial Services Fund's portfolio, constructed on a security-by-security, bottom-up approach with a careful eye on risk, was generally well positioned to take advantage of these conditions and performed reasonably well on an absolute basis. However, relative to the Fund's benchmark, the Standard & Poor's® 500 (S&P 500®) Financials Index, the Fund lagged but delivered lower volatility.1

One of the most interesting developments of the first half of the year came in late June at a press conference held by Fed Chairman Ben Bernanke. In keeping with the Fed's efforts, particularly those of the Chairman, to be "more transparent," Bernanke explained the Fed's thought process concerning a winding down of the Fed's extraordinary and unprecedented efforts to stimulate the economy and employment. While it has always been clear that the Fed's program would have to end or be curtailed substantially, the specific

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^{1.} The S&P 500 Financials Index is market capitalization weighted and consists of all financial stocks in the S&P 500 Index. STANDARD & POOR'S®, S&P® and S&P 500® are registered trademarks of Standard & Poor's Financial Services LLC.

timing has been unclear, which has made securities markets nervous. Bernanke's comments amounted to a commonsense approach of "if things continue to improve at the pace we anticipate, then we will begin to respond later this year." However, the reality of a timetable for this process spooked the bond markets dramatically and the equity markets to a lesser extent. The 10-year Treasury rate climbed from 2.16% at the start of June to 2.52% by month-end, and bond markets experienced major selling across the board. Pundits suggested the great bull market in bonds was finally over and the much anticipated rotation out of bonds into equities had begun.

European equity markets were weak relative to the strong U.S. equity market, and economic expectations for most of Europe remained depressed. While in 2012, the European Central Bank's willingness to prevent a liquidity crisis and a complete collapse of the euro propelled the region's markets, the same markets were being weighed down by a lack of growth, leading a growing number of voices to suggest that austerity alone cannot be the solution to the region's debt crisis. The European Commission's decision in May to give some countries more time to complete their austerity plans reflects, we believe, a new flexibility on the part of Europe's politicians, and, we hope, a first step toward possible pro-growth measures after Germany holds elections in September.

Regarding Asia, investors focused on economic, financial and policy events in China and Japan. Elevated concerns about China's slower pace of economic growth put pressure on all Asian financial markets outside of Japan. China's new political leaders appeared resolute on transitioning the economy away from growth driven by low-cost manufacturing to a more mature model that includes greater domestic consumption. The rapid pace of change, the government's attempt to tighten credit growth enough to curb real estate speculation, and the new leadership's hesitancy to bolster economic growth through stimulus measures combined to produce some instability in China's financial markets that affected global markets. Concurrently, the new Japanese commitment to more aggressive measures against deflation was the biggest financial market driver in that country. The yen dropped versus the dollar from highs set in late 2011 to levels of five years ago. This devaluation was perceived to strengthen Japanese exporters' competitive position, and Japanese equity prices rose in response. However, in a country with few natural resources, a depreciating currency also translates into higher import prices for raw materials, and those higher input costs may offset some of the perceived currency benefits. In addition, rising U.S. bond yields may have begun to attract capital out of Asian markets and into U.S. bonds.

Although markets remain in a situation of excess liquidity primed by central banks' QE stimulus, it seems we are now looking forward to potential tapering of QE and a gradual return to more normal monetary conditions. While we are cautious not to get too far ahead of central banks, we have gradually increased our exposure to the financials sector's more interest-rate sensitive segments. As a result, the Fund's exposure to life insurers and casualty insurers has increased. It will be some time before cash rates move higher, in our view, but life insurers have benefited from gradually rising rates for longer maturity bonds.

Within the insurance industry, the Fund found value in the unloved European companies, which were buffeted by low interest rates and volatility from the euro crisis in 2011 and 2012. Delta Lloyd is an Amsterdam-based insurance company primarily focused on life insurance in the Netherlands and Belgium.² We were attracted to Delta Lloyd's strong management team, excess reserve position and well-capitalized balance sheet. Management set forth a financial strategy in 2012 to decrease the volatility of its balance sheet and earnings, which could lead to a lower cost of equity. In addition, changes in the Dutch pension laws could increase business prospects as Delta Lloyd is viewed as the premier pension manager in the Netherlands. We expect Delta Lloyd's strength to become apparent to the market as it delivers strong earnings and capital growth.

Norway-based StoreBrand provides a variety of insurance and asset management services through its subsidiaries.³ In 2012, the company replaced its CEO with the CFO, Odd Arild Grefstad, who had a reputation as an operator focused on generating adequate returns with an eye on cost efficiency. He subsequently initiated a focus on products with lower capital requirements such as fee-based defined contribution plans and identified significant cost savings for 2013. The market remained concerned, however, about a potential equity raise in the shadow of the upcoming Solvency II Directive, European Union risk management measures that would place strict capital requirements on Norwegian defined benefit pension insurers. However, we believe implementation is far enough in the future for regulators to address potential problems and for the company to alleviate capital requirement pressures. At period-end, we believed the regulatory risk was more than priced into StoreBrand shares, which traded at a significant discount to book value.

^{2.} Mutual Financial Services Fund's holdings are based on total net assets as of 6/30/13: Delta Lloyd 1.7%.

^{3.} Mutual Financial Services Fund's holdings are based on total net assets as of 6/30/13: StoreBrand 1.5%.

As rates have begun to move higher and bond values have declined, we have also seen early signs of investors reallocating savings away from bonds and into stocks. It is our view that this reallocation as well as the associated volatility in the bond market bodes well for financial exchanges through potentially higher volumes, as well as for wealth managers through higher margin equity products.

We remain cognizant of the fact that a normalization of monetary conditions is not universally positive. We have been avoiding companies that overextended their balance sheets by investing in assets with longer maturities to achieve greater yield. Those long-maturity assets are hard to match up against funding. As rates normalize, the cost of funding would rise against their static asset yield, causing spreads to diminish. Long-maturity bonds would decline in value as well as potentially impair the companies' capital.

Thus far, 2013 has been characterized by performance differentials across asset classes and across the globe. In some regions the recovery from the global financial crisis continues and monetary authorities have begun to look at the end of stimulus, while other regions expect lower levels of sustainable growth. We believe these different forces should continue to provide the Fund with attractive opportunities to allocate capital and generate attractive, long-term returns for our investors.

We thank you for your trust and your support.

Sincerely,

Peter A. Langerman

Chairman, President and Chief Executive Officer

Franklin Mutual Advisers, LLC

Peter A Langerman

The letter reflects our analysis, opinions and portfolio holdings as of June 30, 2013, the end of the reporting period. The way we implement our main investment strategies and the resulting portfolio holdings may change depending on factors such as market and economic conditions. These opinions may not be relied upon as investment advice or an offer for a particular security. The information is not a complete analysis of every aspect of any market, country, industry, security or the Fund. Statements of fact are from sources considered reliable, but the investment manager makes no representation or warranty as to their completeness or accuracy. Although historical performance is no guarantee of future results, these insights may help you understand our investment management philosophy.

Semiannual Report

Mutual Financial Services Fund

Your Fund's Goals and Main Investments: Mutual Financial Services Fund seeks capital appreciation, with income as a secondary goal, by investing at least 80% of its net assets in securities of financial services companies that the manager believes are available at market prices less than their intrinsic value. The Fund concentrates its investments in securities of issuers such as banks, savings and loan organizations, credit card companies, brokerage firms, finance companies, subprime lending institutions, investment advisors, investment companies and insurance companies.

Performance data represent past performance, which does not guarantee future results. Investment return and principal value will fluctuate, and you may have a gain or loss when you sell your shares. Current performance may differ from figures shown. Please visit franklintempleton.com or call (800) 342-5236 for most recent month-end performance.

This semiannual report for Mutual Financial Services Fund covers the period ended June 30, 2013.

Performance Overview

Mutual Financial Services Fund – Class Z delivered a +10.74% cumulative total return for the six months under review. For comparison, the Fund's narrow benchmark, the Standard & Poor's 500 (S&P 500) Financials Index, which tracks financials stocks in the S&P 500 Index, generated a +19.50% total return. For the same period, the Fund's broad benchmark, the S&P 500 Index, which is a broad measure of U.S. stock performance, posted a +13.82% total return.1 You can find the Fund's short- and long-term performance data in the Performance Summary beginning on page 11.

Economic and Market Overview

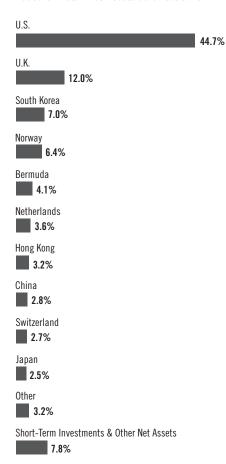
Modest U.S. economic growth, as measured by gross domestic product, characterized the six-month period ended June 30, 2013. Increasing job creation helped lower the unemployment rate and absorb new job seekers, and consumer spending remained strong. Accelerating new and existing home sales accompanied record-low mortgage rates, affordable housing prices, low newhome inventories and a six-year low in U.S. foreclosures. Manufacturing, a mainstay of economic productivity, expanded every month except May.

The dollar value, number of shares or principal amount, and names of all portfolio holdings are listed in the Fund's Statement of Investments (SOI). The SOI begins on page 20.

^{1.} Source: © 2013 Morningstar. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. The indexes are unmanaged and include reinvested dividends. One cannot invest directly in an index, and an index is not representative of the Fund's portfolio.

Geographic Breakdown

Based on Total Net Assets as of 6/30/13



Budgetary agreement between Congress and the President on January 1 preserved lower income tax rates for most U.S. households, but concerns remained about how the expired payroll tax cut, far-reaching federal spending cuts, and future federal debt ceiling negotiations could affect the U.S. economic recovery. Washington's lack of consensus on proposed expenditure reductions resulted in further across-the-board federal spending cuts starting in March. In May, Federal Reserve Board (Fed) Chairman Ben Bernanke said the Fed could gradually wind down its monthly purchases of mortgage-backed securities and Treasuries, assuming continued U.S. economic improvement. He clarified in June that such action could begin in the near future.

Amid these fiscal and monetary developments, a slow and steady U.S. recovery continued. U.S. stocks generated healthy returns as the S&P 500 Index and Dow Jones Industrial Average reached all-time highs during the period, even though Chairman Bernanke's statements sparked sell-offs. Rising corporate profits and generally favorable economic data bolstered investor confidence, but caution remained about the extent to which positive business and market results were dependent on continuation of the Fed's accommodative monetary policy.

The global economic recovery was mixed during the first half of 2013. Emerging markets continued to lead the recovery, although they showed signs of slowing. Growth in the U.S. was slow by the standards of previous recoveries, while the eurozone economy continued to contract. As fears eased surrounding the issues of sovereign debt in Europe, the possibility of another recession in the U.S., and a potential "hard landing" in China, financial market performance was positive. Improving sentiment, relatively strong fundamentals, and continued provision of global liquidity supported risk assets as equity markets performed well and bond prices generally declined. Policymakers in the largest developed economies increased their already unprecedented efforts to supply liquidity. Actions elsewhere in the world were mixed, with some policymakers less willing to reverse previous tightening efforts in response to the external environment.

The MSCI All Country World Index, which measures global developed and emerging stock performance, advanced during the first six months of 2013. Although emerging markets declined, the losses were more than offset by developed market gains. Regional performance was more consistent with local economic trends, although periodic volatility reflected the global economy's fragility. Given the rise in rates near period end, longer duration U.S. Treasury and emerging market bond prices experienced meaningful price declines. In the second quarter, gold, traditionally a safe haven, posted its worst quarterly performance since 1974 as inflation expectations remained

subdued and global commodities stayed under pressure. Investor sentiment improved in the last week of the period, and global stock prices rebounded from period lows after China's central bank intervened to calm the country's interbank market, positive economic reports helped stabilize Japanese government bond yields and several Fed members reassured investors that the Fed's accommodative monetary policy would continue.

Investment Strategy

We strive to provide investors with superior risk-adjusted returns over time through our distinctive, value investment style, which includes investments in undervalued common stocks, distressed debt and risk arbitrage. Rigorous fundamental analysis drives our investment process. We attempt to determine each investment's intrinsic value as well as the price at which we would be willing to commit shareholder funds. While valuation remains our key consideration, we utilize numerous fundamental factors such as return on equity, financial leverage and long-term earnings power. We also consider factors such as management quality and competitive position. As always, our approach to investing is as much about assessing risk and containing losses as it is about achieving profits.

In addition, it is our practice to hedge the Fund's currency exposure when we deem it advantageous for our shareholders.

Manager's Discussion

In an environment of generally rising equity prices, many Fund investments increased in value during the six-month period. Top contributors included insurers CNO Financial, MetLife and ACE.

CNO Financial is a diversified life insurance company focused on serving the less affluent senior and middle-income markets. CNO stock performed well during the period as the company remained on a path toward improved profitability. Recently, higher investment income and lower corporate expenses have supported earnings. In addition, improvement in CNO's operational performance led independent rating agency Standard & Poor's to upgrade the company's credit rating, albeit still at a non-investment grade level. CNO's goal is to achieve investment-grade debt ratings in the next few years.

Solid fiscal first-quarter 2013 results and a dividend increase led MetLife shares higher. The life insurer reported better-than-expected earnings and an improvement in margins. In May, the company raised its dividend by 50%, marking the first increase since 2007. Shares continued to trade at a discount to book value despite solid operating results in a difficult interest rate and

What is return on equity?

Return on equity is an amount, expressed as a percentage, earned on a company's common stock investment for a given period. It is calculated by dividing common stock equity (net worth) over the average of the accounting period into net income for the period after preferred stock dividends but before common stock dividends. Return on equity tells common shareholders how effectually their money is being employed. Comparing percentages for current and prior periods also reveals trends, and comparison with industry composites reveals how well a company is holding its own against its competitors.

What is meant by "hedge"?

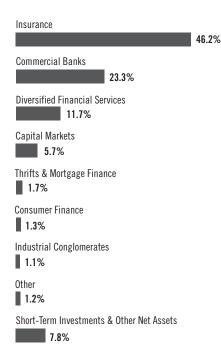
To hedge a position is to seek to reduce the risk of adverse price movements in an asset. Normally, a hedge is implemented as an offsetting position in a related security, such as a currency forward contract.

What is a currency forward contract?

A currency forward contract, also called a "currency forward," is an agreement between the Fund and a counterparty to buy or sell a foreign currency at a specific exchange rate on a future date.

Portfolio Breakdown

Based on Total Net Assets as of 6/30/13



regulatory environment, and the company maintained a high-quality balance sheet. At period-end, our analysis led us to believe the stock had further upside potential.

ACE is a global insurance and reinsurance company operating in more than 170 countries. We believe the company is one of the most disciplined underwriters in the industry, and this ability helped produce strong fiscal first-quarter 2013 results as momentum continued for net premiums earned. The company also noted that the pricing environment remained positive. Based on our analysis at period-end, the company could feasibly earn a double-digit return on equity, which may provide additional upside potential if ACE can compound its book value more quickly than its peers.

During the period under review, some of the Fund's investments negatively affected performance. These included U.S. bank holding company Bond Street Holdings, and South Korean financial services groups KB Financial Group and Woori Finance Holdings.

Bond Street Holdings reported positive first-quarter results led by solid loan growth in its portfolio of Floridian community and commercial banks. The Miami-based holding company also reported reductions in costs, primarily in integration, professional and credit-related expenses. Although our investment in Bond Street declined in value during the period, we believe the company has been making progress toward reaching a healthy level of profitability.

KB Financial shares declined amid generally weak performance for South Korean financials during the period. Slower domestic growth led the Bank of Korea to lower its official policy rate in May, putting downward pressure on the net interest margins (NIMs) of South Korean banks. NIM is a profitability measure relating the difference between interest income earned on a bank's assets and interest paid on its liabilities. Encouragingly, the South Korean government approved supplementary government spending in an effort to stimulate economic growth. Given KB Financial's robust capital and liquidity levels, the group expressed its readiness to expand should the monetary and fiscal stimulus measures succeed in effecting improvement in economic conditions.

Woori Finance Holdings also suffered from the weakness in South Korean financials. The group was formed when the South Korean government, acting through the state-run Korea Deposit Insurance Corporation, assumed control of several of the country's struggling banks during the 1997 Asian financial crisis. Late in the reporting period, the government announced plans to split up and sell its stake in various Woori units by the end of 2014 in its fourth effort to deconsolidate and privatize Woori Finance Holdings. We believe the sale process has the potential to unlock value that has been obscured under the holding company structure.

During the period, the Fund held currency forwards and futures to hedge a portion of the currency risk of the portfolio's non-U.S. dollar investments. The hedges had a positive impact on the Fund's performance during the period.

Thank you for your continued participation in Mutual Financial Services Fund. We look forward to continuing to serve your investment needs.



Andrew Sleeman, CFA Portfolio Manager



Richard Cetlin Assistant Portfolio Manager

Mutual Financial Services Fund

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The foregoing information reflects our analysis, opinions and portfolio holdings as of June 30, 2013, the end of the reporting period. The way we implement our main investment strategies and the resulting portfolio holdings may change depending on factors such as market and economic conditions. These opinions may not be relied upon as investment advice or an offer for a particular security. The information is not a complete analysis of every aspect of any market, country, industry, security or the Fund. Statements of fact are from sources considered reliable, but the investment manager makes no representation or warranty as to their completeness or accuracy. Although historical performance is no guarantee of future results, these insights may help you understand our investment management philosophy.

What is a futures contract?

A futures contract, also called a "future," is an agreement between the Fund and a counterparty made through a U.S. or foreign futures exchange to buy or sell a security at a specific price on a future date.

Top 10 Equity Holdings 6/30/13

Company Sector/Industry, Country	% of Total Net Assets
ACE Ltd. Insurance, U.S.	3.4%
CNO Financial Group Inc. Insurance, U.S.	3.2%
Protector Forsikring ASA <i>Insurance, Norway</i>	2.9%
PartnerRe Ltd. Insurance, Bermuda	2.8%
Aozora Bank Ltd. Commercial Banks, Japan	2.4%
Enstar Group Ltd. Insurance, U.S.	2.4%
Catlin Group Ltd. Insurance, U.K.	2.2%
Resolution Ltd. Insurance, U.K.	2.2%
MetLife Inc. Insurance, U.S.	2.1%
Wells Fargo & Co. Commercial Banks, U.S.	2.1%

Andrew Sleeman has been portfolio manager for Mutual Financial Services Fund since 2009. He has also been a co-portfolio manager for Mutual International Fund since 2009. Mr. Sleeman joined Franklin Templeton Investments in 2007. Previously, he was with Fox-Pitt, Kelton, a financials specialist firm, where he focused on international financial equities. Prior to that, he worked in international equities at BNP Paribas. Mr. Sleeman also worked in Australia in the fixed income division of JP Morgan Investment Management.

Richard Cetlin has been assistant portfolio manager for Mutual Financial Services Fund since 2010 with primary coverage of European banks. Prior to joining Franklin Templeton Investments in 2010, Mr. Cetlin was a consultant for Asian Century Quest, a hedge fund focused on the Asia-Pacific region. In this role, he focused on the analysis of banking, insurance and real estate stocks in China and banking stocks in Hong Kong and South Korea. Prior to that, Mr. Cetlin worked for 14 years at AllianceBernstein where he was a senior vice president and senior analyst for U.S. banking and specialty finance.

Performance Summary as of 6/30/13

Your dividend income will vary depending on dividends or interest paid by securities in the Fund's portfolio, adjusted for operating expenses of each class. Capital gain distributions are net profits realized from the sale of portfolio securities. The performance table does not reflect any taxes that a shareholder would pay on Fund dividends, capital gain distributions, if any, or any realized gains on the sale of Fund shares. Total return reflects reinvestment of the Fund's dividends and capital gain distributions, if any, and any unrealized gains or losses.

Price Information

Class Z (Symbol: TEFAX)	Change	6/30/13	12/31/12
Net Asset Value (NAV)	+\$1.46	\$15.05	\$13.59
Class A (Symbol: TFSIX)	Change	6/30/13	12/31/12
Net Asset Value (NAV)	+\$1.44	\$15.08	\$13.64
Class C (Symbol: TMFSX)	Change	6/30/13	12/31/12
Class C (Symbol: TMFSX) Net Asset Value (NAV)	Change +\$1.40	6/30/13 \$15.01	12/31/12 \$13.61

Performance Summary (continued)

Performance

Cumulative total return excludes sales charges. Aggregate and average annual total return and value of \$10,000 investment include maximum sales charges. Class Z/R6: no sales charges; Class A: 5.75% maximum initial sales charge; Class C: 1% contingent deferred sales charge in first year only.

Class Z	6-Month	1-Year	5-Year	10-Year
Cumulative Total Return ¹	+10.74%	+23.74%	+20.32%	+58.85%
Average Annual Total Return ²	+10.74%	+23.74%	+3.77%	+4.74%
Value of \$10,000 Investment ³	\$11,074	\$12,374	\$12,032	\$15,885
Total Annual Operating Expenses ⁴	1.2	24%		
Class A	6-Month	1-Year	5-Year	10-Year
Cumulative Total Return ¹	+10.56%	+23.32%	+18.52%	+54.01%
Average Annual Total Return ²	+4.22%	+16.20%	+2.23%	+3.80%
Value of \$10,000 Investment ³	\$10,422	\$11,620	\$11,168	\$14,519
Total Annual Operating Expenses ⁴	1.54%			
Class C	6-Month	1-Year	5-Year	10-Year
Cumulative Total Return ¹	+10.29%	+22.41%	+14.40%	+43.73%
Average Annual Total Return ²	+9.29%	+21.41%	+2.73%	+3.69%
Value of \$10,000 Investment ³	\$10,929	\$12,141	\$11,440	\$14,373
Total Annual Operating Expenses ⁴	2.2	24%		
Class R6				Inception (5/1/13)
Cumulative Total Return ¹				+1.07%
Aggregate Total Return ⁵				+1.07%
Value of \$10,000 Investment ³				\$10,107
Total Annual Operating Expenses ⁴	0.9	9%		

Performance data represent past performance, which does not guarantee future results. Investment return and principal value will fluctuate, and you may have a gain or loss when you sell your shares. Current performance may differ from figures shown. For most recent month-end performance, go to franklintempleton.com or call (800) 342-5236.

Performance Summary (continued)

Endnotes

All investments involve risks, including possible loss of principal. Value securities may not increase in price as anticipated or may decline further in value. Investing in a single-sector fund involves special risks, including greater sensitivity to economic, political or regulatory developments impacting the sector. In addition, the Fund invests in foreign securities whose risks include currency fluctuations, and economic and political uncertainties. The Fund's investments in smaller company stocks carry an increased risk of price fluctuation, particularly over the short term. The Fund may also 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 actively managed but there is no guarantee that the manager's investment decisions will produce the desired results. The Fund's prospectus also includes a description of the main investment risks.

- Shares are available to certain eligible investors as described in the prospectus. Class Z:
- Class C: Prior to 1/1/04, these shares were offered with an initial sales charge; thus actual total returns would have differed. These shares have higher annual fees and expenses than Class A shares.
- Class R6: Shares are available to certain eligible investors as described in the prospectus.
- 1. Cumulative total return represents the change in value of an investment over the periods indicated.
- 2. Average annual total return represents the average annual change in value of an investment over the periods indicated. Six-month return has not been annualized.
- 3. These figures represent the value of a hypothetical \$10,000 investment in the Fund over the periods indicated.
- 4. Figures are as stated in the current prospectus. In periods of market volatility, assets may decline significantly, causing total annual Fund operating expenses to become higher than the figures shown.
- 5. Aggregate total return represents the change in value of an investment for the period indicated. Since Class R6 shares have existed for less than one year, average annual total return is not available.

Your Fund's Expenses

As a Fund shareholder, you can incur two types of costs:

- Transaction costs, including sales charges (loads) on Fund purchases; and
- Ongoing Fund costs, including management fees, distribution and service (12b-1) fees, and other Fund expenses. All mutual funds have ongoing costs, sometimes referred to as operating expenses.

The following table shows ongoing costs of investing in the Fund and can help you understand these costs and compare them with those of other mutual funds. The table assumes a \$1,000 investment held for the six months indicated.

Actual Fund Expenses

The first line (Actual) for each share class listed in the table provides actual account values and expenses. The "Ending Account Value" is derived from the Fund's actual return, which includes the effect of Fund expenses.

You can estimate the expenses you paid during the period by following these steps. Of course, your account value and expenses will differ from those in this illustration:

- 1. Divide your account value by \$1,000. If an account had an \$8,600 value, then $$8,600 \div $1,000 = 8.6$.
- 2. Multiply the result by the number under the heading "Expenses Paid During Period." If Expenses Paid During Period were \$7.50, then $8.6 \times 7.50 = 64.50$.

In this illustration, the estimated expenses paid this period are \$64.50.

Hypothetical Example for Comparison with Other Funds

Information in the second line (Hypothetical) for each class in the table can help you compare ongoing costs of investing in the Fund with those of other mutual funds. This information may not be used to estimate the actual ending account balance or expenses you paid during the period. The hypothetical "Ending Account Value" is based on the actual expense ratio for each class and an assumed 5% annual rate of return before expenses, which does not represent the Fund's actual return. The figure under the heading "Expenses Paid During Period" shows the hypothetical expenses your account would have incurred under this scenario. You can compare this figure with the 5% hypothetical examples that appear in shareholder reports of other funds.

Your Fund's Expenses (continued)

Please note that expenses shown in the table are meant to highlight ongoing costs and do not reflect any transaction costs, such as sales charges. Therefore, the second line for each class is useful in comparing ongoing costs only, and will not help you compare total costs of owning different funds. In addition, if transaction costs were included, your total costs would have been higher. Please refer to the Fund prospectus for additional information on operating expenses.

Class Z	Beginning Account Value 1/1/13	Ending Account Value 6/30/13	Expenses Paid During Period* 1/1/13–6/30/13
Actual	\$1,000	\$1,107.40	\$ 6.17
Hypothetical (5% return before expenses)	\$1,000	\$1,018.94	\$ 5.91
Class A			
Actual	\$1,000	\$1,105.60	\$ 7.73
Hypothetical (5% return before expenses)	\$1,000	\$1,017.46	\$ 7.40
Class C			
Actual	\$1,000	\$1,102.10	\$11.37
Hypothetical (5% return before expenses)	\$1,000	\$1,013.98	\$10.89
Class R6			
Actual (5/1/13-6/30/13)	\$1,000	\$1,010.70	\$ 1.63
Hypothetical (5% return before expenses)	\$1,000	\$1,018.94	\$ 4.86

^{*}Expenses are calculated using the most recent six-month expense ratio, annualized for each class (Z: 1.18%; A: 1.48%; C: 2.18%; and R6: 0.97%), multiplied by the average account value over the period, multiplied by 181/365 to reflect the one-half year period for Class R6 Hypothetical expenses and Actual and Hypothetical expenses for Classes Z, A and C. The multiplier is 61/365 for Actual Class R6 expenses to reflect the number of days since inception.

Financial Highlights

	Six Months Ende		Year E	Ended Decem	ber 31,	
Class Z	(unaudited)	2012	2011	2010	2009	2008
Per share operating performance (for a share outstanding throughout the period)						
Net asset value, beginning of period	\$13.59	\$11.53	\$13.01	\$12.05	\$10.80	\$18.68
Income from investment operations ^a :						
Net investment income ^b	0.18	0.20	0.28	0.26	0.15c	0.46
Net realized and unrealized gains (losses)	1.28	2.09	(1.48)	1.27	1.44	(7.94)
Total from investment operations	1.46	2.29	(1.20)	1.53	1.59	(7.48)
Less distributions from net investment income	_	(0.23)	(0.28)	(0.57)	(0.34)	(0.40)
Redemption fees ^d	_	_	_	_	_	е
Net asset value, end of period	\$15.05	\$13.59	\$11.53	\$13.01	\$12.05	\$10.80
Total return ^f	10.74%	19.98%	(9.26)%	12.84%	14.82%	(40.08)%
Ratios to average net assetsg						
Expenses before expense reduction ^h	1.18%	1.24%	1.24%	1.28%	1.26%	1.19%
Expenses net of expense reduction ^h	1.18%	1.24%	1.24%	1.28%	1.25%	1.19% ⁱ
Expenses incurred in connection with securities						
sold short	—%	—%	—%	—%	—%j	0.01%
Net investment income	2.47%	1.56%	2.22%	2.07%	1.24% ^c	3.15%
Supplemental data						
Net assets, end of period (000's)	\$95,234	\$86,519	\$80,105	\$97,487	\$99,610	\$91,691
Portfolio turnover rate	13.96%	12.65%	23.58%	35.37%	81.29%	41.98%

^aThe amount shown for a share outstanding throughout the period may not correlate with the Statement of Operations for the period due to the timing of sales and repurchases of the Fund shares in relation to income earned and/or fluctuating market value of the investments of the Fund.

^bBased on average daily shares outstanding.

Net investment income per share includes approximately \$(0.09) per share related to an adjustment for uncollectible interest. Excluding the effect of this adjustment, the ratio of net investment income to average net assets would have been 2.09%.

dEffective September 1, 2008, the redemption fee was eliminated.

eAmount rounds to less than \$0.01 per share.

^{&#}x27;Total return is not annualized for periods less than one year.

gRatios are annualized for periods less than one year.

Includes dividend expense on securities sold short and borrowing fees, if any. See below for the ratios of such expenses to average net assets for the periods presented.

ⁱBenefit of expense reduction rounds to less than 0.01%.

Rounds to less than 0.01%.

Financial Highlights (continued)

	Six Months End June 30, 201		Year	Ended Decem	ıber 31,	
Class A	(unaudited)	2012	2011	2010	2009	2008
Per share operating performance (for a share outstanding throughout the period)						
Net asset value, beginning of period	\$13.64	\$11.57	\$13.05	\$12.09	\$10.83	\$18.70
Income from investment operations ^a :						
Net investment income ^b	0.16	0.16	0.25	0.22	0.11c	0.42
Net realized and unrealized gains (losses)	1.28	2.10	(1.49)	1.27	1.46	(7.93)
Total from investment operations	1.44	2.26	(1.24)	1.49	1.57	(7.51)
Less distributions from net investment income		(0.19)	(0.24)	(0.53)	(0.31)	(0.36)
Redemption feesd	_	_	_	_	_	е
Net asset value, end of period	\$15.08	\$13.64	\$11.57	\$13.05	\$12.09	\$10.83
Total return ^f	10.56%	19.55%	(9.49)%	12.45%	14.53%	(40.23)%
Ratios to average net assetsg						
Expenses before expense reduction ^h	1.48%	1.54%	1.54%	1.58%	1.55%	1.49%
Expenses net of expense reduction ^h	1.48%	1.54%	1.54%	1.58%	1.54%	1.49% ⁱ
Expenses incurred in connection with securities sold short	—%	—%	—%	—%	—%j	0.01%
Net investment income	2.17%	1.26%	1.92%	1.77%	0.95% ^c	2.85%
Supplemental data						
Net assets, end of period (000's)	\$208,586	\$184,681	\$173,167	\$226,172	\$245,251	\$260,479
Portfolio turnover rate	13.96%	12.65%	23.58%	35.37%	81.29%	41.98%

aThe amount shown for a share outstanding throughout the period may not correlate with the Statement of Operations for the period due to the timing of sales and repurchases of the Fund shares in relation to income earned and/or fluctuating market value of the investments of the Fund.

Rounds to less than 0.01%.

^bBased on average daily shares outstanding.

eNet investment income per share includes approximately \$(0.09) per share related to an adjustment for uncollectible interest. Excluding the effect of this adjustment, the ratio of net investment income to average net assets would have been 1.80%.

dEffective September 1, 2008, the redemption fee was eliminated.

eAmount rounds to less than \$0.01 per share.

Total return does not reflect sales commissions or contingent deferred sales charges, if applicable, and is not annualized for periods less than one year.

gRatios are annualized for periods less than one year.

Includes dividend expense on securities sold short and borrowing fees, if any. See below for the ratios of such expenses to average net assets for the periods presented.

ⁱBenefit of expense reduction rounds to less than 0.01%.

Financial Highlights (continued)

	Six Months Ende		Year E	Inded Decemi	ber 31,	
Class C	(unaudited)	2012	2011	2010	2009	2008
Per share operating performance (for a share outstanding throughout the period)						
Net asset value, beginning of period	\$13.61	\$11.55	\$13.01	\$12.05	\$10.80	\$18.59
Income from investment operations ^a :						
Net investment income ^b	0.11	0.07	0.16	0.13	0.03c	0.31
Net realized and unrealized gains (losses)	1.29	2.08	(1.48)	1.26	1.44	(7.85)
Total from investment operations	1.40	2.15	(1.32)	1.39	1.47	(7.54)
Less distributions from net investment income	_	(0.09)	(0.14)	(0.43)	(0.22)	(0.25)
Redemption fees ^d	_	_	_	_	_	е
Net asset value, end of period	\$15.01	\$13.61	\$11.55	\$13.01	\$12.05	\$10.80
Total return ^f	10.29%	18.67%	(10.13)%	11.69%	13.64%	(40.63)%
Ratios to average net assetsg						
Expenses before expense reduction ^h	2.18%	2.24%	2.24%	2.28%	2.26%	2.19%
Expenses net of expense reduction ^h	2.18%	2.24%	2.24%	2.28%	2.25%	2.19% ⁱ
Expenses incurred in connection with securities sold short	—%	—%	—%	—%	—%j	0.01%
Net investment income	1.47%	0.56%	1.22%	1.07%	0.24% ^c	2.15%
Supplemental data						
Net assets, end of period (000's)	\$75,009	\$69,046	\$68,324	\$89,989	\$97,404	\$103,509
Portfolio turnover rate	13.96%	12.65%	23.58%	35.37%	81.29%	41.98%

The amount shown for a share outstanding throughout the period may not correlate with the Statement of Operations for the period due to the timing of sales and repurchases of the Fund shares in relation to income earned and/or fluctuating market value of the investments of the Fund.

^bBased on average daily shares outstanding.

Net investment income per share includes approximately \$(0.09) per share related to an adjustment for uncollectible interest. Excluding the effect of this adjustment, the ratio of net investment income to average net assets would have been 1.09%.

dEffective September 1, 2008, the redemption fee was eliminated.

eAmount rounds to less than \$0.01 per share.

Total return does not reflect sales commissions or contingent deferred sales charges, if applicable, and is not annualized for periods less than one year.

gRatios are annualized for periods less than one year.

Includes dividend expense on securities sold short and borrowing fees, if any. See below for the ratios of such expenses to average net assets for the periods presented.

ⁱBenefit of expense reduction rounds to less than 0.01%.

Rounds to less than 0.01%.

Financial Highlights (continued)

Class R6	Period Ended June 30, 2013 ^a (unaudited)
Per share operating performance (for a share outstanding throughout the period)	
Net asset value, beginning of period	\$14.89
Income from investment operations ^b :	
Net investment income ^c	0.06
Net realized and unrealized gains (losses)	0.10
Total from investment operations	0.16
Net asset value, end of period	\$15.05
Total return ^d	1.07%
Ratios to average net assets ^e	
Expenses	0.97%
Net investment income	2.68%
Supplemental data	
Net assets, end of period (000's)	\$5
Portfolio turnover rate	13.96%

^aFor the period May 1, 2013 (effective date) to June 30, 2013.

bThe amount shown for a share outstanding throughout the period may not correlate with the Statement of Operations for the period due to the timing of sales and repurchases of the Fund shares in relation to income earned and/or fluctuating market value of the investments of the Fund.

^cBased on average daily shares outstanding.

dTotal return is not annualized for periods less than one year.

eRatios are annualized for periods less than one year.

Statement of Investments, June 30, 2013 (unaudited)

	Country	Shares/Rights/ Units/Warrants	Value
Common Stocks and Other Equity Interests 87.6%			
Capital Markets 4.0%			
The Blackstone Group LP	United States	132,792	\$ 2,796,599
F&C Asset Management PLC	United Kingdom	2,090,659	3,023,780
Morgan Stanley	United States	199,300	4,868,899
Sun Hung Kai & Co. Ltd.	Hong Kong	3,042,704	1,686,915
UBS AG	Switzerland	163,557	2,783,507
			15,159,700
Commercial Banks 23.1%			
^{a,b} AB&T Financial Corp	United States	226,100	171,836
Aozora Bank Ltd	Japan	2,950,341	9,220,745
a,c The Bankshares Inc	United States	456,903	2,191,860
Barclays PLC	United Kingdom	604,684	2,560,490
BB&T Corp	United States	61,700	2,090,396
^{a,d} Bond Street Holdings LLC, A, 144A	United States	286,469	4,153,801
^a Capital Bank Financial Corp., A	United States	42,649	809,905
^{a,d} Capital Bank Financial Corp., B, 144A, non voting	United States	153,021	2,905,869
a CIT Group Inc	United States	130,640	6,091,743
Columbia Banking System Inc.	United States	178,332	4,246,085
^{a,c} Columbia Banking System Inc., wts., C, 10/23/16	United States	8,117	1,233,630
^c First Southern Bancorp Inc.	United States	110,792	549,728
Guaranty Bancorp	United States	266,761	3,027,737
Hana Financial Group Inc.	South Korea	243,313	7,081,720
HSBC Holdings PLC	United Kingdom	561,180	5,820,243
KB Financial Group Inc	South Korea	177,578	5,316,148
PNC Financial Services Group Inc	United States	84,290	6,146,427
Societe Generale	France	48,020	1,650,138
Southern National Bancorp of Virginia Inc	United States	547,560	5,355,137
State Bank Financial Corp	United States	200,000	3,006,000
SunTrust Banks Inc	United States	60,181	1,899,914
Wells Fargo & Co	United States	196,250	8,099,237
Woori Finance Holdings Co. Ltd	South Korea	424,550	3,920,695
			87,549,484
Consumer Finance 1.3%			
a Comdisco Holding Co. Inc.	United States	103	510
Samsung Card Co. Ltd	South Korea	141,770	4,827,427
danisang dara do. Eta	Jouth Roica	141,770	4,827,937
			4,027,337
Diversified Financial Services 9.6%			
Citigroup Inc.	United States	65,609	3,147,264
Deutsche Boerse AG	Germany	18,602	1,224,466
First Pacific Co. Ltd.	Hong Kong	7,515,469	8,042,650
First Pacific Co. Ltd., rts., 7/03/13	Hong Kong	939,433	17,442
a ING Groep NV, IDR	Netherlands	802,283	7,310,042
JPMorgan Chase & Co	United States	89,140	4,705,701
NYSE Euronext	United States	107,601	4,454,681
Oslo Bors VPS Holding ASA	Norway	911,000	7,499,794
			36,402,040

Statement of Investments, June 30, 2013 (unaudited) (continued)

	Country	Shares/Rights/ Units/Warrants	Value
Common Stocks and Other Equity Interests (continued))		
Industrial Conglomerates 1.1%	01.	1 001 000	4 0.070.100
Shanghai Industrial Holdings Ltd	China	1,281,000	\$ 3,972,183
Insurance 46.2%			
ACE Ltd	United States	144,170	12,900,331
Ageas	Belgium	208,183	7,309,722
^a Alleghany Corp	United States	12,747	4,886,052
^a American International Group Inc	United States	154,888	6,923,494
Argo Group International Holdings Ltd	United States	105,712	4,481,132
Aspen Insurance Holdings Ltd	United States	125,616	4,659,097
Catlin Group Ltd	United Kingdom	1,109,668	8,421,317
China Pacific Insurance (Group) Co. Ltd., H	China	1,474,387	4,704,914
CNO Financial Group Inc	United States	925,430	11,993,573
Delta Lloyd NV	Netherlands	318,343	6,379,244
Direct Line Insurance Group PLC	United Kingdom	1,227,824	4,352,761
a Enstar Group Ltd.	United States	68,089	9,054,475
a,c Imagine Group Holdings Ltd	Bermuda	68,631	598,222
Korean Reinsurance Co	South Korea	588,351	5,407,638
Lancashire Holdings Ltd.	United Kingdom	295,606	3,554,994
Maiden Holdings Ltd	United States	402,850	4,519,977
MetLife Inc.	United States	177,140	8,105,926
a,c Olympus Re Holdings Ltd.	United States	7,480	10.560.350
PartnerRe Ltd	Bermuda	116,700	10,568,352
PICC Property and Casualty Co. Ltd., H	China	1,773,358	2,002,929
b Protector Forsikring ASA	Norway	4,479,410	10,989,250
RenaissanceRe Holdings Ltd	United States	42,200	3,662,538
Resolution Ltd.	United Kingdom	1,898,597	8,230,766
RSA Insurance Group PLC	United Kingdom	3,816,571	6,910,177
^a Storebrand ASA	Norway Bermuda	1,200,174 119,914	5,789,923 4,331,294
White Mountains Insurance Group Ltd.	United States	12,068	6,938,376
Zurich Insurance Group AG	Switzerland	28,050	7,273,377
Zurien insurance Group Ad	Switzerianu	28,030	
Real Estate Management & Development 0.6%			174,949,851
a Dolphin Capital Investors Ltd.	Virgin Islands (British)	3,979,650	2,284,800
a.c Star Asia Finance Ltd., 144A	Japan	96,850	109,431
otal Asia i manee Ltd., 144A	Japan	30,030	2,394,231
TI 10 0 11 1 TI 170/			
Thrifts & Mortgage Finance 1.7%	Haite d Ot 1	064.660	0.514.000
Cape Bancorp Inc.	United States	264,663	2,514,299
^a TFS Financial Corp	United States	151,800	1,700,160
Westfield Financial Inc	United States	319,620	2,237,340
			6,451,799
Total Common Stocks and Other Equity Interests (Cost \$304,861,152)			331,707,225
Convertible Preferred Stocks 0.2%			
Commercial Banks 0.2%	11 11 101 1	1.004	222 525
Columbia Banking System Inc., cvt. pfd., B	United States	1,224	339,696
c First Southern Bancorp Inc., cvt. pfd., C	United States	190	357,449
Total Convertible Preferred Stocks (Cost \$312,400)			697,145

Statement of Investments, June 30, 2013 (unaudited) (continued)

	Country	Shares/Rights/ Units/Warrants	Value
Preferred Stocks 1.4%			
Diversified Financial Services 1.4%			
a.c Hightower Holding LLC, pfd., A	United States	3,000,000	\$ 3,299,430
a.c Hightower Holding LLC, pfd., A, Series 2	United States	968,000	2,196,537
Total Preferred Stocks (Cost \$4,782,324)			5,495,967
		Principal Amount*	
Corporate Notes 1.3%			
e Canada Square Operations Ltd., junior sub. note,		4 - 4 - 6 - 6 - 6 - 6 - 6 - 6 - 6 - 6 -	0.040.000
Series 19, 7.50% to 12/09/13, FRN thereafter, Perpetual Noble Group Ltd., junior sub. note, 8.50% to 11/01/15,	United Kingdom	1,740,000 GBP	2,646,279
FRN thereafter, Perpetual	Hong Kong	2,500,000	2,425,000
Total Corporate Notes (Cost \$3,708,866)			5,071,279
		Shares	
Companies in Liquidation 1.7% a.c AET&D Holdings No. 1 Pty. Ltd	Australia	490,308	
a.c FIM Coinvestor Holdings I, LLC	United States	4,357,178	_
a,f Lehman Brothers Holdings Inc., Bankruptcy Claim	United States	14,766,103	6,497,085
Total Companies in Liquidation (Cost \$6,626,289)			6,497,085
Total Investments before Short Term Investments			
(Cost \$320,291,031)			349,468,701
		Principal Amount*	
Short Term Investments 4.6%			
U.S. Government and Agency Securities 4.6%			
g FHLB, 7/01/13	United States	1,500,000	1,500,000
g.h U.S. Treasury Bills, 7/05/13 - 11/29/13	United States	15,600,000	15,599,042
Total U.S. Government and Agency Securities (Cost \$17,097,443)			17,099,042
Total Investments (Cost \$337,388,474) 96.8%			366,567,743
Other Assets, less Liabilities 3.2%			12,266,723
Net Assets 100.0%			\$378,834,466
			+0,0,00+,+00

^{*}The principal amount is stated in U.S. dollars unless otherwise indicated.

^aNon-income producing.

bSee Note 10 regarding holdings of 5% voting securities.

^cSee Note 8 regarding restricted securities.

descurity was purchased pursuant to Rule 144A under the Securities Act of 1933 and may be sold in transactions exempt from registration only to qualified institutional buyers or in a public offering registered under the Securities Act of 1933. These securities have been deemed liquid under guidelines approved by the Trust's Board of Trustees. At June 30, 2013, the aggregate value of these securities was \$7,059,670, representing 1.86% of net assets.

ePerpetual security with no stated maturity date.

Bankruptcy claims represent the right to receive distributions, if any, during the liquidation of the underlying pool of assets. Shares represent amount of allowed unsecured claims. gThe security is traded on a discount basis with no stated coupon rate.

Security or a portion of the security has been pledged as collateral for open futures and forward contracts. At June 30, 2013, the aggregate value of these securities and/or cash pledged as collateral was \$666,917, representing 0.18% of net assets.

Statement of Investments, June 30, 2013 (unaudited) (continued)

At June 30, 2013, the Fund had the following futures contracts outstanding. See Note 1(c).

Futures Contracts

Description	Туре	Number of Contracts	Notional Value	Expiration Date	Unrealized Appreciation	Unrea Depred	
Currency Contracts							
EUR/USD	Short	8	\$1,302,300	9/16/13	\$ 27,962	\$	_
GBP/USD	Short	80	7,602,000	9/16/13	213,433		_
Unrealized appreciation (depreciation	on)				241,395		
Net unrealized appreciation (dep	preciation) .				\$241,395		

At June 30, 2013, the Fund had the following forward exchange contracts outstanding. See Note 1(c).

Forward Exchange Contracts

Currency	Counterparty	Туре	Quantity	Contract Amount	Settlement Date	Unrealized Appreciation	Unrealized Depreciation
Euro		Buy	100,000	\$ 131,387	7/17/13	\$ —	\$ (1,212)
Euro	BBU	Buy	107,921	141,172	7/17/13	Ψ	(686)
Euro	BANT	Buy	53,961	70,641	7/17/13	_	(397)
Euro	FBCO	Buy	53,960	70,623	7/17/13	_	(381)
Euro	BBU	Sell	3,029,734	4,045,740	7/17/13	101,781	(561)
Euro	DBFX	Sell	1,273,455	1,706,456	7/17/13	48,734	
Euro	BANT	Sell	128,897	172,851	7/17/13	5,059	
Euro	SCBT	Sell	48,284	64,544	7/17/13	1,689	_
British Pound	BANT	Sell	146,365	221,127	7/19/13		(1,439)
British Pound	HSBC	Sell	44,346	67,055	7/19/13	_	(379)
British Pound	HSBC	Sell	4,407,107	6,712,024	7/19/13	10,462	_
British Pound	BANT	Sell	101,269	154,325	7/19/13	333	_
British Pound	FBCO	Sell	101,270	154,403	7/19/13	410	_
Japanese Yen	SCBT	Sell	955,900,000	9,321,216	7/22/13	_	(316,734)
Japanese Yen	DBFX	Buy	61,956,566	636,034	7/22/13	_	(11,351)
Japanese Yen	DBFX	Buy	76,700,000	751,386	7/22/13	21,949	_
Japanese Yen	FBCO	Buy	8,850,000	87,609	7/22/13	1,622	_
Japanese Yen	FBCO	Sell	26,500,000	278,011	7/22/13	10,823	_
South Korean Won	FBCO	Buy	1,190,955,796	1,058,157	8/12/13	_	(18,066)
South Korean Won	DBFX	Buy	1,097,087,000	961,640	8/12/13	_	(3,527)
South Korean Won	FBCO	Buy	1,289,953,300	1,114,142	8/12/13	12,406	_
South Korean Won	DBFX	Sell	23,391,360,563	21,216,092	8/12/13	787,848	_
South Korean Won	FBCO	Sell	6,040,721,248	5,403,857	8/12/13	128,349	_
South Korean Won	BANT	Sell	2,578,586,335	2,302,838	8/12/13	50,895	_
Swiss Franc	DBFX	Buy	190,548	206,684	8/12/13	_	(4,932)
Swiss Franc	FBCO	Sell	254,528	264,614	8/12/13	_	(4,880)
Swiss Franc	FBCO	Buy	175,757	188,849	8/12/13	_	(2,757)
Swiss Franc	DBFX	Buy	79,400	82,676	8/12/13	1,392	_
Swiss Franc	FBCO	Sell	1,308,592	1,429,287	8/12/13	43,751	_

Statement of Investments, June 30, 2013 (unaudited) (continued)

Forward Exchange Contracts (continued)

					Settlement	Unrealized	Unrealized
Currency	Counterparty	Type	Quantity	Contract Amount	Date	Appreciation	Depreciation
Swiss Franc	DBFX	Sell	1,232,208	\$ 1,345,162	8/12/13	\$ 40,501	\$ —
British Pound	FBCO	Buy	1,500,000	2,290,275	8/19/13	_	(9,825)
British Pound	DBFX	Sell	500,000	753,969	8/19/13	_	(6,181)
British Pound	FBCO	Sell	1,612,921	2,496,801	8/19/13	44,678	_
British Pound	BANT	Sell	2,341,727	3,629,677	8/19/13	69,550	_
British Pound	SCBT	Sell	3,030,716	4,697,610	8/19/13	90,013	_
Euro	DBFX	Sell	743,673	956,699	8/30/13	_	(11,576)
Euro	BANT	Sell	438,892	574,266	8/30/13	2,821	_
Euro	BBU	Sell	415,582	543,586	8/30/13	2,491	_
Euro	HSBC	Sell	46,620	60,944	8/30/13	244	_
Euro	FBCO	Sell	632,702	831,332	8/30/13	7,543	_
Euro	SCBT	Sell	125,678	163,917	8/30/13	282	_
Euro	DBFX	Sell	242,663	318,145	8/30/13	2,194	_
Euro	HAND	Sell	42,915	56,018	8/30/13	142	_
Euro	SSBT	Sell	500,000	655,840	8/30/13	4,832	_
Euro	DBFX	Sell	377,000	490,866	10/16/13	_	(111)
Euro	BANT	Sell	1,497,820	1,962,646	10/16/13	11,996	_
Euro	BBU	Sell	1,504,563	1,970,150	10/16/13	10,718	_
Euro	FBCO	Sell	563,377	740,507	10/16/13	6,806	_
British Pound	BANT	Sell	4,509,503	6,863,464	10/21/13	10,284	_
Euro	FBCO	Sell	2,858,705	3,690,790	11/18/13	_	(35,884)
Euro	DBFX	Sell	203,648	262,919	11/18/13	_	(2,346)
Euro	BANT	Sell	158,743	206,623	11/18/13	_	(858)
Euro	SCBT	Sell	60,877	78,713	11/18/13	_	(583)
Euro	BANT	Sell	91,364	120,506	11/18/13	1,498	_
Euro	HSBC	Sell	63,125	83,005	11/18/13	780	_
Euro	SCBT	Sell	627,473	837,531	11/18/13	20,208	_
Euro	FBCO	Sell	137,746	180,145	11/18/13	723	_
Euro	DBFX	Sell	163,547	216,766	11/18/13	3,735	_
British Pound	DBFX	Buy	810,968	1,258,771	11/21/13	_	(26,547)
British Pound	FBCO	Sell	2,991,094	4,537,490	11/21/13	_	(7,326)
British Pound	DBFX	Sell	2,389,698	3,627,562	11/21/13	_	(3,463)
British Pound	BANT	Sell	2,617,206	3,974,227	11/21/13	_	(2,484)
British Pound	FBCO	Buy	92,399	142,649	11/21/13	_	(2,254)
British Pound	SSBT	Buy	81,833	126,202	11/21/13	_	(1,861)
British Pound		Buy	92,493	142,039	11/21/13	_	(1,500)
Norwegian Krone		Buy	5,400,000	912,655	11/21/13	_	(28,131)
Norwegian Krone		Buy	589,565	99,680	11/21/13	_	(3,110)
Norwegian Krone	FBCO	Sell	150,959,987	25,613,976	11/21/13	886,598	,
Unrealized appreciation (depr						2,446,140	(510,781)
Net unrealized appreciation							(010,701)
ivet unrealized appreciatio	ii (debieciation	17				\$1,935,359	

See Abbreviations on page 44.

Financial Statements

Statement of Assets and Liabilities

June 30, 2013 (unaudited)

Assets: Investments in securities:	
Cost - Unaffiliated issuers	\$ 325,112,552 12,275,922
Total cost of investments	\$ 337,388,474
Value - Unaffiliated issuers	\$ 355,406,657
Value - Non-controlled affiliated issuers (Note 10)	11,161,086
Total value of investments	366,567,743
Cash	3,238,340
Restricted Cash (Note 1d)	960,000
Foreign currency, at value (cost \$12,901,564)	12,887,695
Capital shares sold	704,833
Dividends and interest	457,451
Variation margin	27,400
Unrealized appreciation on forward exchange contracts	2,446,140
Other assets	150,949
Total assets	387,440,551
Liabilities:	
Payables:	
Investment securities purchased	5,604,554
Capital shares redeemed	739,514
Affiliates	539,333
Due to brokers	960,000
Unrealized depreciation on forward exchange contracts	510,781
Accrued expenses and other liabilities	251,903
Total liabilities	8,606,085
Net assets, at value	\$ 378,834,466
Net assets consist of:	
Paid-in capital	\$ 556,970,008
Undistributed net investment income	5,453,750
Net unrealized appreciation (depreciation)	31,356,333
Accumulated net realized gain (loss)	(214,945,625)
Net assets, at value	\$ 378,834,466

Financial Statements (continued)

Statement of Assets and Liabilities (continued)

June 30, 2013 (unaudited)

Class Z:	
Net assets, at value	\$ 95,234,121
Shares outstanding	6,327,408
Net asset value and maximum offering price per share	\$15.05
Class A:	
Net assets, at value	\$ 208,585,984
Shares outstanding	13,828,186
Net asset value per share ^a	\$15.08
Maximum offering price per share (net asset value per share ÷ 94.25%)	\$16.00
Class C:	
Net assets, at value	\$ 75,009,304
Shares outstanding	4,998,396
Net asset value and maximum offering price per share ^a	\$15.01
Class R6:	
Net assets, at value	\$ 5,057
Shares outstanding	336
Net asset value and maximum offering price per share	\$15.05

^aRedemption price is equal to net asset value less contingent deferred sales charges, if applicable.

Financial Statements (continued)

Statement of Operations

for the six months ended June 30, 2013 (unaudited)

Investment income:	
Dividends: (net of foreign taxes of \$671,073)	
Unaffiliated issuers	\$ 5,775,825
Non-controlled affiliated issuers (Note 10)	686,027
Interest	228,049
Income from securities loaned	50,340
Total investment income	6,740,241
Expenses:	
Management fees (Note 3a)	1,473,851
Administrative fees (Note 3b)	140,552
Distribution fees: (Note 3c)	
Class A	302,482
Class B	470
Class C	365,280
Transfer agent fees: (Note 3e)	
Class Z	99,793
Class A	214,565
Class B	102
Class C	77,735
Custodian fees (Note 4)	25,171
Reports to shareholders	42,185
Registration and filing fees	31,498
Professional fees	65,067
Trustees' fees and expenses	8,086
Other	5,879
Total expenses	2,852,716
Net investment income	3,887,525
Realized and unrealized gains (losses):	
Net realized gain (loss) from:	
Investments	6,456,547
Foreign currency transactions	1,941,379
Futures contracts	189,173
Net realized gain (loss)	8,587,099
Net change in unrealized appreciation (depreciation) on:	
Investments	19,109,602
Translation of other assets and liabilities denominated in foreign currencies	4,630,923
Net change in unrealized appreciation (depreciation)	23,740,525
- ''	
Net realized and unrealized gain (loss)	32,327,624
Net increase (decrease) in net assets resulting from operations	\$36,215,149

Financial Statements (continued)

Statements of Changes in Net Assets

	Six Months Ended June 30, 2013 (unaudited)	Year Ended December 31, 2012
Increase (decrease) in net assets:		
Operations:		
Net investment income	\$ 3,887,525	\$ 4,005,426
Net realized gain (loss) from investments, foreign currency transactions and futures		
contracts	8,587,099	14,653,384
Net change in unrealized appreciation (depreciation) on investments and translation of other		
assets and liabilities denominated in foreign currencies	23,740,525	40,432,930
Net increase (decrease) in net assets resulting from operations	36,215,149	59,091,740
Distributions to shareholders from:		
Net investment income:		
Class Z	_	(1,463,197)
Class A	_	(2,589,323)
Class B	_	(2,287)
Class C		(490,530)
Total distributions to shareholders		(4,545,337)
Capital share transactions: (Note 2)		
Class Z	(681,039)	(7,268,399)
Class A	4,111,493	(17,774,465)
Class B	(374,083)	(1,633,368)
Class C	(1,038,888)	(10,673,792)
Class R6	5,000	
Total capital share transactions	2,022,483	(37,350,024)
Net increase (decrease) in net assets	38,237,632	17,196,379
Net assets:		
Beginning of period	340,596,834	323,400,455
End of period	\$378,834,466	\$340,596,834
Undistributed net investment income included in net assets:		
End of period	\$ 5,453,750	\$ 1,566,225

Notes to Financial Statements (unaudited)

1. Organization and Significant Accounting Policies

Franklin Mutual Series Funds (Trust) is registered under the Investment Company Act of 1940, as amended, (1940 Act) as an open-end investment company, consisting of seven separate funds. The Mutual Financial Services Fund (Fund) is included in this report. The financial statements of the remaining funds in the Trust are presented separately. The Fund offers four classes of shares: Class Z, Class A, Class C and Class R6. Effective May 1, 2013, the Fund began offering a new class of shares, Class R6. Effective March 22, 2013, all Class B shares were converted to Class A. Each class of shares differs by its initial sales load, contingent deferred sales charges, voting rights on matters affecting a single class, its exchange privilege and fees primarily due to differing arrangements for distribution and transfer agent fees.

The following summarizes the Fund's significant accounting policies.

a. Financial Instrument Valuation

The Fund's investments in financial instruments are carried at fair value daily. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. Under procedures approved by the Trust's Board of Trustees (the Board), the Fund's administrator, investment manager and other affiliates have formed the Valuation and Liquidity Oversight Committee (VLOC). The VLOC provides administration and oversight of the Fund's valuation policies and procedures, which are approved annually by the Board. Among other things, these procedures allow the Fund to utilize independent pricing services, quotations from securities and financial instrument dealers, and other market sources to determine fair value.

Equity securities and derivative financial instruments (derivatives) listed on an exchange or on the NASDAQ National Market System are valued at the last quoted sale price or the official closing price of the day, respectively. Foreign equity securities are valued as of the close of trading on the foreign stock exchange on which the security is primarily traded, or the NYSE, whichever is earlier. The value is then converted into its U.S. dollar equivalent at the foreign exchange rate in effect at the close of the NYSE on the day that the value of the security is determined. Overthe-counter (OTC) securities are valued within the range of the most recent quoted bid and ask prices. Securities that trade in multiple markets or on multiple exchanges are valued according to the broadest and most representative market. Certain equity securities are valued based upon fundamental characteristics or relationships to similar securities.

Debt securities generally trade in the OTC market rather than on a securities exchange. The Fund's pricing services use multiple valuation techniques to determine fair value. In instances where sufficient market activity exists, the pricing services may utilize a market-based approach through which quotes from market makers are used to determine fair value. In instances where sufficient market activity may not exist or is limited, the pricing services also utilize proprietary valuation models which may consider market characteristics such as benchmark yield curves, credit spreads, estimated default rates, anticipated market interest rate volatility, coupon rates, anticipated timing of principal repayments, underlying collateral, and other unique security

Notes to Financial Statements (unaudited) (continued)

1. Organization and Significant Accounting Policies (continued)

a. Financial Instrument Valuation (continued)

features in order to estimate the relevant cash flows, which are then discounted to calculate the fair value. Securities denominated in a foreign currency are converted into their U.S. dollar equivalent at the foreign exchange rate in effect at the close of the NYSE on the date that the values of the foreign debt securities are determined.

Certain derivatives trade in the OTC market. The Fund's pricing services use various techniques including industry standard option pricing models and proprietary discounted cash flow models to determine the fair value of those instruments. The Fund's net benefit or obligation under the derivative contract, as measured by the fair market value of the contract, is included in net assets.

The Fund has procedures to determine the fair value of financial instruments for which market prices are not reliable or readily available. Under these procedures, the VLOC convenes on a regular basis to review such financial instruments and considers a number of factors, including significant unobservable valuation inputs, when arriving at fair value. The VLOC primarily employs a market-based approach which may use related or comparable assets or liabilities, recent transactions, market multiples, book values, and other relevant information for the investment to determine the fair value of the investment. An income-based valuation approach may also be used in which the anticipated future cash flows of the investment are discounted to calculate fair value. Discounts may also be applied due to the nature or duration of any restrictions on the disposition of the investments. Due to the inherent uncertainty of valuations of such investments, the fair values may differ significantly from the values that would have been used had an active market existed. The VLOC employs various methods for calibrating these valuation approaches including a regular review of key inputs and assumptions, transactional back-testing or disposition analysis, and reviews of any related market activity.

Trading in securities on foreign securities stock exchanges and OTC markets may be completed before the daily close of business on the NYSE. Occasionally, events occur between the time at which trading in a foreign security is completed and the close of the NYSE that might call into question the reliability of the value of a portfolio security held by the Fund. As a result, differences may arise between the value of the Fund's portfolio securities as determined at the foreign market close and the latest indications of value at the close of the NYSE. In order to minimize the potential for these differences, the VLOC monitors price movements following the close of trading in foreign stock markets through a series of country specific market proxies (such as baskets of American Depositary Receipts, futures contracts and exchange traded funds). These price movements are measured against established trigger thresholds for each specific market proxy to assist in determining if an event has occurred that may call into question the reliability of the values of the foreign securities held by the Fund. If such an event occurs, the securities may be valued using fair value procedures, which may include the use of independent pricing services.

In addition, certain foreign markets may be open on days that the NYSE is closed, which could result in differences between the value of the Fund's portfolio securities on the last business day

Notes to Financial Statements (unaudited) (continued)

1. Organization and Significant Accounting Policies (continued)

a. Financial Instrument Valuation (continued)

and the last calendar day of the reporting period. Any significant security valuation changes due to an open foreign market are adjusted and reflected by the Fund for financial reporting purposes.

b. Foreign Currency Translation

Portfolio securities and other assets and liabilities denominated in foreign currencies are translated into U.S. dollars based on the exchange rate of such currencies against U.S. dollars on the date of valuation. The Fund may enter into foreign currency exchange contracts to facilitate transactions denominated in a foreign currency. Purchases and sales of securities, income and expense items denominated in foreign currencies are translated into U.S. dollars at the exchange rate in effect on the transaction date. Portfolio securities and assets and liabilities denominated in foreign currencies contain risks that those currencies will decline in value relative to the U.S. dollar. Occasionally, events may impact the availability or reliability of foreign exchange rates used to convert the U.S. dollar equivalent value. If such an event occurs, the foreign exchange rate will be valued at fair value using procedures established and approved by the Board.

The Fund does not separately report the effect of changes in foreign exchange rates from changes in market prices on securities held. Such changes are included in net realized and unrealized gain or loss from investments on the Statement of Operations.

Realized foreign exchange gains or losses arise from sales of foreign currencies, currency gains or losses realized between the trade and settlement dates on securities transactions and the difference between the recorded amounts of dividends, interest, and foreign withholding taxes and the U.S. dollar equivalent of the amounts actually received or paid. Net unrealized foreign exchange gains and losses arise from changes in foreign exchange rates on foreign denominated assets and liabilities other than investments in securities held at the end of the reporting period.

c. Derivative Financial Instruments

The Fund invested in derivatives in order to manage risk or gain exposure to various other investments or markets. Derivatives are financial contracts based on an underlying or notional amount, require no initial investment or an initial net investment that is smaller than would normally be required to have a similar response to changes in market factors, and require or permit net settlement. Derivatives contain various risks including the potential inability of the counterparty to fulfill their obligations under the terms of the contract, the potential for an illiquid secondary market, and/or the potential for market movements which expose the Fund to gains or losses in excess of the amounts shown on the Statement of Assets and Liabilities. Realized gain and loss and unrealized appreciation and depreciation on these contracts for the period are included in the Statement of Operations.

Derivative counterparty credit risk is managed through a formal evaluation of the creditworthiness of all potential counterparties. The Fund attempts to reduce its exposure to counterparty credit risk on OTC derivatives, whenever possible, by entering into International Swaps and Derivatives

Notes to Financial Statements (unaudited) (continued)

1. Organization and Significant Accounting Policies (continued)

c. Derivative Financial Instruments (continued)

Association (ISDA) master agreements with certain counterparties. These agreements contain various provisions, including but not limited to collateral requirements, events of default, or early termination. Termination events applicable to the counterparty include certain deteriorations in the credit quality of the counterparty. Termination events applicable to the Fund include failure of the Fund to maintain certain net asset levels and/or limit the decline in net assets over various periods of time. In the event of default or early termination, the ISDA master agreement gives the non-defaulting party the right to net and close-out all transactions traded, whether or not arising under the ISDA agreement, to one net amount payable by one counterparty to the other. Early termination by the counterparty may result in an immediate payment by the Fund of any net liability owed to that counterparty under the ISDA agreement. At June 30, 2013, the Fund had OTC derivatives in a net liability position of \$206,337 and the aggregate value of collateral pledged for such contracts was \$505,923. However, absent an event of default or early termination, OTC derivative assets and liabilities are presented gross and not offset in the Statement of Assets and Liabilities.

Collateral requirements differ by type of derivative. Collateral or initial margin requirements are set by the broker or exchange clearing house for exchange traded and centrally cleared derivatives. Initial margin deposited is held at the exchange and can be in the form of cash and/or securities. For OTC derivatives traded under an ISDA master agreement, posting of collateral is required by either the Fund or the applicable counterparty if the total net exposure of all OTC derivatives with the applicable counterparty exceeds the minimum transfer amount, which typically ranges from \$100,000 to \$250,000, and can vary depending on the counterparty and the type of the agreement. Generally, collateral is determined at the close of fund business each day and any additional collateral required due to changes in derivative values may be delivered by the Fund or the counterparty within a few business days. Collateral pledged and/or received by the Fund for OTC derivatives, if any, is held in segregated accounts with the Fund's custodian/ counterparty broker and can be in the form of cash and/or securities. Unrestricted cash may be invested according to the Fund's investment objectives.

At June 30, 2013, the Fund received \$1,254,201 in U.S. Treasury Notes as collateral for derivatives.

The Fund entered into exchange traded futures contracts primarily to manage exposure to certain foreign currencies. A futures contract is an agreement between the Fund and a counterparty to buy or sell an asset for a specified price on a future date. Required initial margin deposits of cash or securities are pledged by the Fund. Subsequent payments, known as variation margin, are made or received by the Fund, depending on fluctuations in the value of the asset underlying the futures contract. Such variation margin is accounted for as unrealized appreciation or depreciation until the contract is closed, at which time the gains or losses are realized.

Notes to Financial Statements (unaudited) (continued)

1. Organization and Significant Accounting Policies (continued)

c. Derivative Financial Instruments (continued)

The Fund entered into OTC forward exchange contracts primarily to manage exposure to certain foreign currencies. A forward exchange contract is an agreement between the Fund and a counterparty to buy or sell a foreign currency at a specific exchange rate on a future date.

See Note 9 regarding other derivative information.

d. Restricted Cash

At June 30, 2013, the Fund received restricted cash in connection with investments in certain derivative securities. Restricted cash is held in a segregated account with the Fund's custodian/ counterparty broker and is reflected in the Statement of Assets and Liabilities.

e. Securities Lending

The Fund participates in an agency based securities lending program. The Fund receives cash collateral against the loaned securities in an amount equal to at least 102% of the market value of the loaned securities. Collateral is maintained over the life of the loan in an amount not less than 100% of the market value of loaned securities, as determined at the close of fund business each day; any additional collateral required due to changes in security values is delivered to the Fund on the next business day. The collateral is invested in a non-registered money fund. The Fund receives income from the investment of cash collateral, in addition to lending fees and rebates paid by the borrower. The Fund bears the market risk with respect to the collateral investment, securities loaned, and the risk that the agent may default on its obligations to the Fund. The securities lending agent has agreed to indemnify the Fund in the event of default by a third party borrower. At June 30, 2013, the Fund had no securities on loan.

f. Income and Deferred Taxes

It is the Fund's policy to qualify as a regulated investment company under the Internal Revenue Code. The Fund intends to distribute to shareholders substantially all of its taxable income and net realized gains to relieve it from federal income and excise taxes. As a result, no provision for U.S. federal income taxes is required.

The Fund may be subject to foreign taxation related to income received, capital gains on the sale of securities and certain foreign currency transactions in the foreign jurisdictions in which it invests. Foreign taxes, if any, are recorded based on the tax regulations and rates that exist in the foreign markets in which the Fund invests. When a capital gain tax is determined to apply the Fund records an estimated deferred tax liability in an amount that would be payable if the securities were disposed of on the valuation date.

The Fund recognizes the tax benefits of uncertain tax positions only when the position is "more likely than not" to be sustained upon examination by the tax authorities based on the technical merits of the tax position. As of June 30, 2013, and for all open tax years, the Fund has determined

Notes to Financial Statements (unaudited) (continued)

1. Organization and Significant Accounting Policies (continued)

f. Income and Deferred Taxes (continued)

that no liability for unrecognized tax benefits is required in the Fund's financial statements related to uncertain tax positions taken on a tax return (or expected to be taken on future tax returns). Open tax years are those that remain subject to examination and are based on each tax jurisdiction statute of limitation.

g. Security Transactions, Investment Income, Expenses and Distributions

Security transactions are accounted for on trade date. Realized gains and losses on security transactions are determined on a specific identification basis. Interest income and estimated expenses are accrued daily. Amortization of premium and accretion of discount on debt securities are included in interest income. Dividend income is recorded on the ex-dividend date except that certain dividends from foreign securities are recognized as soon as the Fund is notified of the ex-dividend date. Distributions to shareholders are recorded on the ex-dividend date and are determined according to income tax regulations (tax basis). Distributable earnings determined on a tax basis may differ from earnings recorded in accordance with accounting principles generally accepted in the United States of America. These differences may be permanent or temporary. Permanent differences are reclassified among capital accounts to reflect their tax character. These reclassifications have no impact on net assets or the results of operations. Temporary differences are not reclassified, as they may reverse in subsequent periods.

Common expenses incurred by the Trust are allocated among the funds based on the ratio of net assets of each fund to the combined net assets of the Trust. Fund specific expenses are charged directly to the fund that incurred the expense.

Realized and unrealized gains and losses and net investment income, not including class specific expenses, are allocated daily to each class of shares based upon the relative proportion of net assets of each class. Differences in per share distributions, by class, are generally due to differences in class specific expenses.

Distributions received by the Fund from certain securities may be a return of capital (ROC). Such distributions reduce the cost basis of the securities, and any distributions in excess of the cost basis are recognized as capital gains.

h. Accounting Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

Notes to Financial Statements (unaudited) (continued)

1. Organization and Significant Accounting Policies (continued)

i. Guarantees and Indemnifications

Under the Trust's organizational documents, its officers and trustees are indemnified by the Trust against certain liabilities arising out of the performance of their duties to the Trust. Additionally, in the normal course of business, the Trust, on behalf of the Fund, enters into contracts with service providers that contain general indemnification clauses. The Trust's maximum exposure under these arrangements is unknown as this would involve future claims that may be made against the Trust that have not yet occurred. Currently, the Trust expects the risk of loss to be remote.

2. SHARES OF BENEFICIAL INTEREST

At June 30, 2013, there were an unlimited number of shares authorized (without par value). Transactions in the Fund's shares were as follows:

	Six Months Ended June 30, 2013			Year Ended December 31, 2012	
	Shares	Amount	Shares	Amount	
Class Z Shares:					
Shares sold	430,140	\$ 6,225,656	1,024,689	\$ 13,275,422	
Shares issued in reinvestment of					
distributions	_	_	96,383	1,304,659	
Shares redeemed	(470,228)	(6,906,695)	(1,703,585)	(21,848,480)	
Net increase (decrease)	(40,088)	\$ (681,039)	(582,513)	\$ (7,268,399)	
Class A Shares:					
Shares sold	1,672,920	\$ 24,608,000	2,053,865	\$ 26,219,145	
Shares issued in reinvestment of					
distributions	_	_	183,716	2,490,728	
Shares redeemed	(1,386,821)	(20,496,507)	(3,664,473)	(46,484,338)	
Net increase (decrease)	286,099	\$ 4,111,493	(1,426,892)	\$(17,774,465)	
Class B Sharesa:					
Shares sold	54	\$ 759	2,961	\$ 36,601	
Shares issued in reinvestment of					
distributions	_	_	166	2,141	
Shares redeemed	(25,977)	(374,842)	(134,684)	(1,672,110)	
Net increase (decrease)	(25,923)	\$ (374,083)	(131,557)	\$ (1,633,368)	
Class C Shares:					
Shares sold	442,551	\$ 6,508,368	393,032	\$ 4,966,381	
Shares issued in reinvestment of					
distributions	_	_	34,214	457,649	
Shares redeemed	(515,604)	(7,547,256)	(1,271,876)	(16,097,822)	
Net increase (decrease)	(73,053)	\$ (1,038,888)	(844,630)	\$(10,673,792)	
Class R6 Sharesb:					
Shares sold	336	\$ 5,000			

^aEffective March 22, 2013, all Class B shares were converted to Class A.

^bFor the period May 1, 2013 (effective date) to June 30, 2013.

Notes to Financial Statements (unaudited) (continued)

3. Transactions with Affiliates

Franklin Resources, Inc. is the holding company for various subsidiaries that together are referred to as Franklin Templeton Investments. Certain officers and trustees of the Fund are also officers, and/or directors of the following subsidiaries:

Subsidiary	Affiliation
Franklin Mutual Advisers, LLC (Franklin Mutual)	Investment manager
Franklin Templeton Services, LLC (FT Services)	Administrative manager
Franklin Templeton Distributors, Inc. (Distributors)	Principal underwriter
Franklin Templeton Investor Services, LLC (Investor Services)	Transfer agent

a. Management Fees

The Fund pays an investment management fee to Franklin Mutual based on the average daily net assets of the Fund as follows:

Annualized Fee Rate	Net Assets
0.800%	Up to and including \$1 billion
0.770%	Over \$1 billion, up to and including \$2 billion
0.750%	Over \$2 billion, up to and including \$5 billion
0.730%	In excess of \$5 billion

b. Administrative Fees

The Fund pays its allocated share of an administrative fee to FT Services based on the Trust's aggregate average daily net assets as follows:

Annualized Fee Rate	Net Assets
0.150%	Up to and including \$200 million
0.135%	Over \$200 million, up to and including \$700 million
0.100%	Over \$700 million, up to and including \$1.2 billion
0.075%	In excess of \$1.2 billion

c. Distribution Fees

The Board has adopted distribution plans for each share class, with the exception of Class Z and Class R6 shares, pursuant to Rule 12b-1 under the 1940 Act. Distribution fees are not charged on shares held by affiliates. Under the Fund's Class A reimbursement distribution plan, the Fund reimburses Distributors for costs incurred in connection with the servicing, sale and distribution of the Fund's shares up to the maximum annual plan rate. Under the Class A reimbursement distribution plan, costs exceeding the maximum for the current plan year cannot be reimbursed in subsequent periods. In addition, under the Fund's Class B and C compensation distribution plans, the Fund pays Distributors for costs incurred in connection with the servicing, sale and distribution of the Fund's shares up to the maximum annual plan rate for each class.

Notes to Financial Statements (unaudited) (continued)

3. Transactions with Affiliates (continued)

c. Distribution Fees (continued)

The maximum annual plan rates, based on the average daily net assets, for each class, are as follows:

Class A	0.35%
Class B	1.00%
Class C	1.00%

The Board has set the current rate at 0.30% per year for Class A shares until further notice and approval by the Board.

d. Sales Charges/Underwriting Agreements

Front-end sales charges and contingent deferred sales charges (CDSC) do not represent expenses of the Fund. These charges are deducted from the proceeds of sales of Fund shares prior to investment or from redemption proceeds prior to remittance, as applicable. Distributors has advised the Fund of the following commission transactions related to the sales and redemptions of the Fund's shares for the period:

Sales charges retained net of commissions paid to	
unaffiliated broker/dealers	\$42,148
CDSC retained	\$ 2.800

e. Transfer Agent Fees

Each class of shares, except for Class R6, pays transfer agent fees to Investor Services for its performance of shareholder servicing obligations and reimburses Investor Services for out of pocket expenses incurred, including shareholding servicing fees paid to third parties. These fees are allocated daily based upon their relative proportion of such classes' aggregate net assets. Class R6 pays Investor Services transfer agent fees specific to that class.

For the period ended June 30, 2013, the Fund paid transfer agent fees of \$392,195, of which \$223,084 was retained by Investor Services.

4. EXPENSE OFFSET ARRANGEMENT

The Fund has entered into an arrangement with its custodian whereby credits realized as a result of uninvested cash balances are used to reduce a portion of the Fund's custodian expenses. During the period ended June 30, 2013, there were no credits earned.

Notes to Financial Statements (unaudited) (continued)

5. INDEPENDENT TRUSTEES' RETIREMENT PLAN

On January 1, 1993, the Trust adopted an Independent Trustees' Retirement Plan (Plan). The Plan is an unfunded defined benefit plan that provides benefit payments to Trustees whose length of service and retirement age meets the eligibility requirements of the Plan. Benefits under the Plan are based on years of service and fees paid to each trustee at the time of retirement. Effective in December 1996, the Plan was closed to new participants.

During the period ended June 30, 2013, the Fund's projected benefit obligation and benefit payments under the Plan were as follows:

^a Projected benefit obligation at June 30, 2013	\$ 2	26,002
bIncrease in projected benefit obligation	\$	2,320
Benefit payments made to retired trustees	\$	233

^aThe projected benefit obligation is included in accrued expenses and other liabilities in the Statement of Assets and Liabilities.

6. INCOME TAXES

For tax purposes, capital losses may be carried over to offset future capital gains, if any. Capital loss carryforwards with no expiration, if any, must be fully utilized before those losses with expiration dates.

At December 31, 2012, capital loss carryforwards were as follows:

Capital loss carryforwards subject to expiration:	
2016	\$105,848,544
2017	73,527,713
2018	31,091,133
Capital loss carryforwards not subject to expiration:	
Short term	5,468,895
Long term	9,057,430
Total capital loss carryforwards	\$224,993,715

At June 30, 2013, the cost of investments and net unrealized appreciation (depreciation) for income tax purposes were as follows:

Cost of investments	\$337,671,913
Unrealized appreciation	\$ 84,109,023
Unrealized depreciation	(55,213,193)
Net unrealized appreciation (depreciation)	\$ 28,895,830

Differences between income and/or capital gains as determined on a book basis and a tax basis are primarily due to differing treatments of foreign currency transactions and passive foreign investment company shares.

bThe increase in projected benefit obligation is included in trustees' fees and expenses in the Statement of Operations.

Notes to Financial Statements (unaudited) (continued)

7. INVESTMENT TRANSACTIONS

Purchases and sales of investments (excluding short term securities) for the period ended June 30, 2013, aggregated \$58,834,049 and \$46,055,922, respectively.

8. RESTRICTED SECURITIES

The Fund invests in securities that are restricted under the Securities Act of 1933 (1933 Act) or which are subject to legal, contractual, or other agreed upon restrictions on resale. Restricted securities are often purchased in private placement transactions, and cannot be sold without prior registration unless the sale is pursuant to an exemption under the 1933 Act. Disposal of these securities may require greater effort and expense, and prompt sale at an acceptable price may be difficult. The Fund may have registration rights for restricted securities. The issuer generally incurs all registration costs.

At June 30, 2013, the Fund held investments in restricted securities, excluding certain securities exempt from registration under the 1933 Act deemed to be liquid, as follows:

Shares/		Acquisition		
Units	Issuer	Dates	Cost	Value
490,308	AET&D Holdings No. 1 Pty. Ltd	10/13/10	\$ —	\$ —
456,903	The Bankshares Inc	3/22/07	4,569,030	2,191,860
8,117	^a Columbia Banking System Inc., wts., C, 10/23/16	10/23/09	_	1,233,630
4,357,178	FIM Coinvestor Holdings I, LLC	11/20/06 - 6/02/09	_	_
110,792	First Southern Bancorp Inc	1/27/10 - 7/07/10	2,337,711	549,728
190	First Southern Bancorp Inc., cvt. pfd., C	1/27/10 - 7/07/10	190,000	357,449
3,000,000	Hightower Holding LLC, pfd., A	3/31/08 - 1/05/10	2,362,324	3,299,430
968,000	Hightower Holding LLC, pfd., A, Series 2	6/10/10 - 5/10/12	2,420,000	2,196,537
68,631	Imagine Group Holdings Ltd	8/31/04	702,884	598,222
7,480	Olympus Re Holdings Ltd	12/19/01	702,552	_
96,850	Star Asia Finance Ltd., 144A	2/22/07 - 5/18/07	9,836,925	109,431
	Total Restricted Securities (Value is 2.78%	of Net Assets)	\$23,121,426	\$10,536,287

^aThe Fund also invests in unrestricted securities or other investments in the issuer, valued at \$4,585,781 as of June 30, 2013.

Notes to Financial Statements (unaudited) (continued)

9. OTHER DERIVATIVE INFORMATION

At June 30, 2013, the Fund's investments in derivative contracts are reflected on the Statement of Assets and Liabilities as follows:

Asset Derivatives Liability Derivatives

Derivative Contracts Not Accounted for as Hedging Instruments	Statement of Assets and Liabilities Location	Fair Value Amount	Statement of Assets and Liabilities Location	Fair Value Amount
Foreign exchange contracts	Unrealized appreciation on forward exchange contracts / Net assets consist of - net unrealized appreciation (depreciation)	\$2,687,535ª	Unrealized depreciation on forward exchange contracts	\$510,781

alncludes cumulative appreciation (depreciation) of futures contracts as reported in the Statement of Investments. Only current day's variation margin is separately reported within the Statement of Assets and Liabilities.

For the period ended June 30, 2013, the effect of derivative contracts on the Fund's Statement of Operations was as follows:

Derivative Contracts Not Accounted for as Hedging Instruments	Statement of Operations Locations	Realized Gain (Loss) for the Period	Change in Unrealized Appreciation (Depreciation) for the Period
Foreign exchange contracts	Net realized gain (loss) from foreign currency transactions and futures contracts / Net change in unrealized appreciation (depreciation) on translation of other assets and liabilities denominated in foreign currencies	\$3,155,940	\$4,619,518

For the period ended June 30, 2013, the average month end market value of derivatives represented 0.93% of average month end net assets. The average month end number of open derivative contracts for the period was 101.

See Note 1(c) regarding derivative financial instruments.

10. Holdings of 5% Voting Securities of Portfolio Companies

The 1940 Act defines "affiliated companies" to include investments in portfolio companies in which a fund owns 5% or more of the outstanding voting securities. Investments in "affiliated companies" for the Fund for the period ended June 30, 2013, were as shown below.

Name of Issuer	Number of Shares Held at Beginning of Period	Gross Additions	Gross Reductions	Number of Shares Held at End of Period	Value at End of Period	Investment Income	Realized Capital Gain (Loss)
Non-Controlled Affiliates							
AB&T Financial Corp	226,100	_	_	226,100	\$ 171,836	\$ —	\$
Protector Forsikring ASA	4,479,410	_	_	4,479,410	10,989,250	686,027	_
Total Affiliated Securities (Valu	e is 2.95% of Net A	ssets)			\$11,161,086	\$686,027	\$—

Notes to Financial Statements (unaudited) (continued)

11. CREDIT FACILITY

The Fund, together with other U.S. registered and foreign investment funds (collectively, Borrowers), managed by Franklin Templeton Investments, are borrowers in a joint syndicated senior unsecured credit facility totaling \$1.5 billion (Global Credit Facility) which matures on January 17, 2014. This Global Credit Facility provides a source of funds to the Borrowers for temporary and emergency purposes, including the ability to meet future unanticipated or unusually large redemption requests.

Under the terms of the Global Credit Facility, the Fund shall, in addition to interest charged on any borrowings made by the Fund and other costs incurred by the Fund, pay its share of fees and expenses incurred in connection with the implementation and maintenance of the Global Credit Facility, based upon its relative share of the aggregate net assets of all of the Borrowers, including an annual commitment fee of 0.07% based upon the unused portion of the Global Credit Facility. These fees are reflected in other expenses on the Statement of Operations. During the period ended June 30, 2013, the Fund did not use the Global Credit Facility.

12. FAIR VALUE MEASUREMENTS

The Fund follows a fair value hierarchy that distinguishes between market data obtained from independent sources (observable inputs) and the Fund's own market assumptions (unobservable inputs). These inputs are used in determining the value of the Fund's financial instruments and are summarized in the following fair value hierarchy:

- Level 1 quoted prices in active markets for identical financial instruments
- Level 2 other significant observable inputs (including quoted prices for similar financial instruments, interest rates, prepayment speed, credit risk, etc.)
- Level 3 significant unobservable inputs (including the Fund's own assumptions in determining the fair value of financial instruments)

The inputs or methodology used for valuing financial instruments are not an indication of the risk associated with investing in those financial instruments.

For movements between the levels within the fair value hierarchy, the Fund has adopted a policy of recognizing the transfers as of the date of the underlying event which caused the movement.

Notes to Financial Statements (unaudited) (continued)

12. FAIR VALUE MEASUREMENTS (continued)

A summary of inputs used as of June 30, 2013, in valuing the Fund's assets and liabilities carried at fair value, is as follows:

	Level 1	Level 2	Level 3	Total
Assets:				
Investments in Securities:				
Equity Investments: ^a				
Commercial Banks	\$ 79,248,629	\$ 4,665,333	\$ 4,332,667	\$ 88,246,629
Diversified Financial Services	36,402,040	_	5,495,967	41,898,007
Insurance	174,351,629	_	598,222b	174,949,851
Real Estate Management &				
Development	2,284,800	_	109,431	2,394,231
All Other Equity Investments ^c	30,411,619	_	_	30,411,619
Corporate Notes	_	5,071,279	_	5,071,279
Companies in Liquidation	_	6,497,085	b	6,497,085
Short Term Investments	15,599,042	1,500,000	_	17,099,042
Total Investments in Securities	\$338,297,759	\$17,733,697	\$10,536,287	\$366,567,743
Futures Contracts	\$ 241,395	\$ —	\$ —	\$ 241,395
Forward Exchange Contracts	_	2,446,140	_	2,446,140
Liabilities:				
Forward Exchange Contracts	_	510,781	_	510,781

^aIncludes common, convertible preferred and preferred stocks as well as other equity investments.

A reconciliation of assets in which Level 3 inputs are used in determining fair value is presented when there are significant Level 3 investments at the end of the period. At June 30, 2013, the reconciliation of assets, is as follows:

	Balance at Beginning of Period	Purchases (Sales)	Transfers Into Level 3	Transfers Out of Level 3 ^a	Cost Basis Adjustments	Net Realized Gain (Loss)	Net Unrealized Gain (Loss)	Balance at End of Period	Net Change in Unrealized Appreciation (Depreciation) on Assets Held at Period End
Assets:									
Investments in Securities: Equity Investments: ^b									
Commercial Banks	\$10,856,078	\$	\$	\$(7,110,235)	\$	\$	\$ 586,824	\$ 4,332,667	\$ 670,429
Diversified Financial Services	5,154,639	_	_	_	_	_	341,328	5,495,967	341,328
Insurance	792,077°	_	_	_	_	_	(193,855)	598,222c	(193,855)
Real Estate Management & Development	159,657	_	_	_	_	_	(50,226)	109,431	(50,226)
Total	\$16,962,451	\$	\$	\$(7,110,235)	\$—	\$	\$ 684,071	\$10,536,287	\$ 767,676

^aThe investments were transferred out of Level 3 as a result of the removal of a significant unobservable valuation input and/or the availability of a broker quote.

blncludes securities determined to have no value at June 30, 2013.

cFor detailed categories, see the accompanying Statement of Investments.

blncludes common, convertible preferred and preferred stocks as well as other equity investments.

clncludes securities determined to have no value.

Notes to Financial Statements (unaudited) (continued)

12. FAIR VALUE MEASUREMENTS (continued)

Significant unobservable valuation inputs developed by the VLOC for material Level 3 investments and impact to fair value as a result of changes in unobservable valuation inputs as of June 30, 2013, are as follows:

Description	Fair Value at End of Period	Valuation Technique	Unobservable Inputs	Amount/ Range	Impact to Fair Value if Input Increases ^a
Assets:					
Investments in Securities:					
Equity Investments:b					
Commercial Banks	\$ 4,332,667	Market comparables	Discount for lack of marketability Price / tangible book	10%	Decrease ^c
			multiple	1.0x - 1.4x	Increased
		Option pricing model	Stock price volatility	22.7%	Increase
Diversified Financial Services	5,495,967	Discounted cash	Cost of equity	17.4%	Decrease
		flow model	Long-term revenue growth rate Adjusted EBITDA	6.2% - 40.2%	Increased
			margin	6% - 21%	Increased
Insurance	598,222	Market comparables	Discount for lack of		
			marketability	5%	Decreasec
			Price / book multiple	1.0x	Increasec
All Other Investments ^e	109,431				
Total	\$10,536,287				

Represents the directional change in the fair value of the Level 3 investments that would result from a significant and reasonable increase in the corresponding input. A significant and reasonable decrease in the input would have the opposite effect. Significant impacts, if any, to fair value and/or net assets have been indicated.

See Abbreviations on page 44.

13. New Accounting Pronouncements

In June 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-08, Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements. The ASU modifies the criteria used in defining an investment company under U.S. Generally Accepted Accounting Principles and also sets forth certain measurement and disclosure requirements. Under the ASU, an entity that is registered under the 1940 Act automatically qualifies as an investment company. The ASU is effective for interim and annual reporting periods beginning after December 15, 2013. The Fund is currently reviewing the requirements and believes the adoption of this ASU will not have a material impact on its financial statements.

blncludes common, convertible preferred and preferred stocks.

cRepresents a significant impact to fair value but not net assets.

dRepresents a significant impact to fair value and net assets.

elncludes fair value of immaterial investments developed using various valuation techniques and unobservable inputs. May also include investments with values derived using prior transaction prices or third party pricing information without adjustment for which such inputs are also unobservable.

Notes to Financial Statements (unaudited) (continued)

14. Subsequent Events

The Fund has evaluated subsequent events through the issuance of the financial statements and determined that no events have occurred that require disclosure.

ABBREVIATIONS

Counterparty

BANT - Bank of America N.A. BBU - Barclays Bank PLC DBFX - Deutsche Bank AG **FBCO** - Credit Suisse Group AG HAND - Svenska Handelsbanken HSBC - HSBC Bank USA, N.A. SCBT - Standard Chartered Bank

SSBT - State Street Bank and Trust Co., N.A.

Selected Notes

EBITDA - Earnings before interest, taxes, depreciation and amortization

Currency

EUR - Euro

GBP - British Pound USD - United States Dollar

Selected Portfolio

FHLB - Federal Home Loan Bank FRN - Floating Rate Note

IDR - International Depositary Receipt

Shareholder Information

Board Review of Investment Management Agreement

The Board of Trustees (Board), including the independent trustees, at a Board meeting held on May 21, 2013, unanimously approved renewal of the Fund's investment management agreement, as well as the Fund's administrative services agreement. Prior to a meeting of all of the trustees for the purpose of considering such renewals, the independent trustees held two meetings dedicated to the renewal process (those trustees unable to attend in person were present by telephonic conference means). Throughout the process, the independent trustees received assistance and advice from and met separately with independent counsel. The independent trustees met with and interviewed officers of the investment manager (including portfolio managers), the transfer agent and shareholder services group and the distributor. In approving the renewal of the investment management agreement and the administrative services agreement for the Fund, the Board, including the independent trustees, determined that the existing investment management fee structure was fair and reasonable and that continuance of the agreements was in the best interests of the Fund and its shareholders.

In reaching their decision on the investment management agreement (as well as the administrative services agreement), the trustees took into account information furnished throughout the year at regular Board meetings, as well as information specifically requested and furnished for the renewal process, which culminated in the meetings referred to above for the specific purpose of considering such agreements. Information furnished throughout the year included, among others, reports on the Fund's investment performance, expenses, portfolio composition, portfolio brokerage execution, client commission arrangements, derivatives, securities lending, portfolio turnover, Rule 12b-1 plans, distribution, shareholder servicing, legal and compliance matters, pricing of securities and sales and redemptions, as well as a third-party survey of transfer agent fees charged funds within the Franklin Templeton Investments complex in comparison with those charged other fund complexes deemed comparable. Also, related financial statements and other information about the scope and quality of services provided by the investment manager and its affiliates and enhancements to such services over the past year were provided. In addition, the trustees received periodic reports throughout the year and during the renewal process relating to compliance with the Fund's investment policies and restrictions. During the renewal process, the independent trustees considered the investment manager's methods of operation within the Franklin Templeton group and its activities on behalf of other clients.

The information obtained by the trustees during the renewal process also included a special report prepared by Lipper, Inc. (Lipper), an independent third-party analyst, comparing the Fund's investment performance and expenses with those of other mutual funds deemed comparable to the Fund as selected by Lipper (Lipper Section 15(c) Report). The trustees reviewed the Lipper Section 15(c) Report and its usefulness in the renewal process with respect to matters such as comparative fees, expenses, expense ratios, performance and volatility. They concluded that the report continues to be a reliable resource in the performance of their duties.

Shareholder Information (continued)

Board Review of Investment Management Agreement (continued)

In addition, the trustees received a Profitability Study (Profitability Study) prepared by management discussing the profitability to Franklin Templeton Investments from its overall U.S. Fund operations, as well as on an individual fund-by-fund basis. Over the past year, the Board and counsel to the independent trustees continued to receive reports on management's handling of recent regulatory inquiries and pending legal actions against the investment manager and its affiliates. The independent trustees were satisfied with the actions taken to date by management in response to such regulatory and legal proceedings.

Particular attention was given to management's diligent risk management procedures, including continuous monitoring of counterparty credit risk and attention given to derivatives and other complex instruments. The Board also took into account, among other things, management's efforts in establishing a global credit facility for the benefit of the Fund and other accounts managed by Franklin Templeton Investments to provide a source of cash for temporary and emergency purposes or to meet unusual redemption requests as well as the strong financial position of the investment manager's parent company and its commitment to the mutual fund business. In addition, the Board received updates from management on the Securities and Exchange Commission's (SEC) progress in implementing the rule-making requirements established by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which was enacted July 21, 2010, and the investment manager's compliance with rules and regulations already promulgated by the SEC under such act.

In addition to the above and other matters considered by the trustees throughout the course of the year, the following discussion relates to certain primary factors relevant to the Board's decision. This discussion of the information and factors considered by the Board (as well as the discussion above) is not intended to be exhaustive, but rather summarizes certain factors considered by the Board. In view of the wide variety of factors considered, the Board did not, unless otherwise noted, find it practicable to quantify or otherwise assign relative weights to the foregoing factors. In addition, individual trustees may have assigned different weights to various factors.

NATURE, EXTENT AND QUALITY OF SERVICES. The trustees reviewed the nature, extent and quality of the services provided by the investment manager. In this regard, they reviewed the Fund's investment approach and concluded that, in their view, it continues to differentiate the Fund from typical core investment products in the mutual fund field. The trustees cited the investment manager's ability to implement the Fund's disciplined value investment approach and its long-term relationship with the Fund as reasons that shareholders choose to invest, and remain invested, in the Fund. The trustees reviewed the Fund's portfolio management team, including its performance, staffing, skills and compensation program. With respect to portfolio manager compensation, management assured the trustees that the Fund's long-term performance is a significant component of incentive-based compensation and noted that a portion of a portfolio manager's incentive-based compensation is paid in shares of predesignated funds from the portfolio manager's fund management area. The trustees noted that the portfolio manager compensation program aligned the interests of the portfolio managers with that of Fund shareholders. The trustees discussed with management various other products, portfolios and entities that are advised by the investment manager

Shareholder Information (continued)

Board Review of Investment Management Agreement (continued)

and the allocation of assets and expenses among and within them, as well as their relative fees and reasons for differences with respect thereto and any potential conflicts.

During regular Board meetings and the aforementioned meetings of the independent trustees, the trustees received reports and presentations on the investment manager's best execution trading policies. The trustees considered periodic reports provided to them showing that the investment manager complied with the investment policies and restrictions of the Fund as well as other reports periodically furnished to the Board covering matters such as the compliance of portfolio managers and other management personnel with the code of ethics covering the investment management personnel, the adherence to fair value pricing procedures established by the Board and the accuracy of net asset value calculations. The Board noted the extent of the benefits provided to Fund shareholders from being part of the Franklin Templeton group, including the right to exchange investments between funds (same class) without a sales charge, the ability to reinvest Fund dividends into other funds and the right to combine holdings of other funds to obtain reduced sales charges. The trustees considered the investment manager's substantial efforts in developing and implementing compliance procedures established in accordance with SEC and other requirements.

The trustees also reviewed the nature, extent and quality of the Fund's other service agreements to determine that, on an overall basis, Fund shareholders were well served. In this connection, the Board also took into account administrative and transfer agent and shareholder services provided to Fund shareholders by an affiliate of the investment manager, noting continuing expenditures by management to increase and improve the scope of such services and favorable periodic reports on shareholder services conducted by independent third parties. While such considerations directly affected the trustees' decision in renewing the Fund's administrative services and transfer agent and shareholder services agreement, the Board also considered these commitments as incidental benefits to Fund shareholders deriving from the investment management relationship.

Based on their review, the trustees were satisfied with the nature and quality of the overall services provided by the investment manager and its affiliates to the Fund and its shareholders and were confident in the abilities of the management team to continue the disciplined value investment approach of the Fund and to provide quality services to the Fund and its shareholders.

INVESTMENT PERFORMANCE. The trustees reviewed and placed significant emphasis on the investment performance of the Fund over the one-, three-, five- and 10-year periods ended December 31, 2012. They considered the history of successful performance of the Fund relative to various benchmarks. As part of their review, they inquired of management regarding benchmarks, style drift and restrictions on permitted investments. Consideration was also given to performance in the context of available levels of cash during the periods. The trustees had meetings during the year, including the meetings referred to above held in connection with the renewal process, with the Fund's portfolio managers to discuss performance and the management of the Fund. In addition, particular attention in assessing performance was given to the Lipper Section 15(c) Report. That report showed the investment performance of the Fund (Class A shares) in comparison to other funds determined comparable by Lipper.

Shareholder Information (continued)

Board Review of Investment Management Agreement (continued)

The comparable funds to the Fund, as chosen by Lipper, included all retail and institutional global financial services funds. The Fund had total returns in the lowest performing quintile for the one-year period ended December 31, 2012, and had annualized total returns for the three- and five-year periods in the middle performing quintile. The trustees noted that the Fund's total return on an annualized basis for the 10-year period ended December 31, 2012, was in the second-lowest performing quintile. The Board discussed with the investment manager the reasons for the relative underperformance for the one- and 10-year periods ended December 31, 2012. While noting such discussions and intending to continuously monitor future performance, the Board did not believe that such performance warranted any change in portfolio management, noting that the Fund's one-year total return exceeded 19.5%, and its 10-year total return was within 35 basis points of the Lipper performance universe median.

The trustees also compared Fund performance to other industry benchmarks, including measures of risk-adjusted performance of a fund, as part of their evaluation of investment performance. The trustees concluded that the Fund had continued to perform well in comparison to its various benchmarks and in the context of the Fund's objectives.

COMPARATIVE EXPENSES AND MANAGEMENT PROFITABILITY. The trustees considered the cost of the services provided and to be provided and the profits realized by the investment manager and its affiliates from their respective relationships with the Fund. As part of the approval process, they explored with management the trends in expense ratios over the past three fiscal years and the reasons for any increases in the Fund's expense ratios (or components thereof). In considering the appropriateness of the management fee and other expenses charged to the Fund, the Board took into account various factors including investment performance and matters relating to Fund operations, including, but not limited to, the quality and experience of its portfolio managers and research staff. Consideration was also given to a comparative analysis in the Lipper Section 15(c) Report of the investment management fee and total expense ratio of the Fund in comparison with those of a group of other funds selected by Lipper as its appropriate Lipper expense group. Lipper expense data is based upon information taken from the Fund's most recent annual report, which reflects historical asset levels that may be quite different from those currently existing, particularly in a period of market volatility. While recognizing such inherent limitation and the fact that expense ratios generally increase as assets decline and decrease as assets grow, the Board believed the independent analysis conducted by Lipper to be an appropriate measure of comparative expenses.

In reviewing comparative costs, emphasis was given to the Fund's contractual management fee in comparison with the contractual management fee that would have been charged by other funds within its Lipper expense group assuming they were similar in size to the Fund, as well as the actual total expenses of the Fund in comparison with those of its Lipper expense group. The Lipper contractual management fee analysis includes administrative charges as being part of the management fee, and total expenses, for comparative consistency, are shown by Lipper for Fund Class A shares.

Shareholder Information (continued)

Board Review of Investment Management Agreement (continued)

The Fund's contractual management fee rate was in the second-most expensive quintile of its Lipper expense group and its total expenses were in the most expensive quintile of such group. The Board noted that the Fund's contractual management fee rate was within 7.6 basis points of its Lipper expense group median and that the Fund's total expenses were within 11.8 basis points of its Lipper expense group median. The Board found such comparative fees and expenses to be acceptable in view of factors relating to the Fund's operations, such as the quality and experience of its portfolio managers.

The trustees also reviewed the Profitability Study addressing profitability of Franklin Resources, Inc., from its overall U.S. fund business, as well as profitability to the Fund's investment manager and its affiliates, from providing investment management and other services to the Fund during the 12-month period ended September 30, 2012, the most recent fiscal year-end of Franklin Resources, Inc. The trustees reviewed the basis on which such reports are prepared and the cost allocation methodology utilized in the Profitability Study, it being recognized that allocation methodologies may each be reasonable while producing different results. In this respect, the Board noted that the reasonableness of the cost allocation methodologies was reviewed by independent accountants on an every other year basis.

The independent trustees met with management to discuss the Profitability Study. This included, among other things, a comparison of investment management income with investment management expenses of the Fund; comparison of underwriting revenues and expenses; the relative relationship of investment management and underwriting expenses; shareholder servicing profitability; economies of scale; and the relative contribution of the Fund to the profitability of the investment manager and its parent. In discussing the Profitability Study with the Board, the investment manager stated its belief that the costs incurred in establishing the infrastructure necessary to operate the type of mutual fund operations conducted by it and its affiliates may not be fully reflected in the expenses allocated to the Fund in determining its profitability.

The trustees considered an additional Lipper study analyzing the profitability of the parent of the investment manager as compared to other publicly held investment managers, which also aided the trustees in considering profitability excluding distribution costs. The Board also took into account management's expenditures in improving shareholder services provided to the Fund, as well as the need to meet additional regulatory and compliance requirements resulting from the Sarbanes-Oxley Act, the Dodd-Frank Act and recent SEC and other regulatory requirements. The trustees also considered the extent to which the investment manager may derive ancillary benefits from Fund operations, including those derived from economies of scale, discussed below, the allocation of Fund brokerage and the use of commission dollars to pay for research and other similar services.

Based upon their consideration of all these factors, the trustees determined that the level of profits realized by the manager and its affiliates in providing services to the Fund was not excessive in view of the nature, quality and extent of services provided.

Shareholder Information (continued)

Board Review of Investment Management Agreement (continued)

ECONOMIES OF SCALE. The trustees considered economies of scale realized by the investment manager and its affiliates as the Fund grows larger and the extent to which they are shared with Fund shareholders, as for example, in the level of the investment management fee charged, in the quality and efficiency of services rendered and in increased capital commitments benefiting the Fund directly or indirectly. While recognizing that any precise determination is inherently subjective, the trustees noted that, based upon the Profitability Study, as some funds increase in size, at some point economies of scale may result in the investment manager realizing a larger profit margin on investment management services provided to such a fund. The trustees also noted that benefits of economies of scale will be shared with Fund shareholders due to the decline in the effective investment management fee rate as breakpoints are achieved by the Fund.

The trustees noted that breakpoints had been instituted as part of the Fund's investment management fee in 2004. The trustees assessed the breakpoints and believed they were, and continue to be, appropriate and they agreed to continue to monitor the appropriateness of the breakpoints. The trustees also considered the effects an increase in assets under management would have on the investment management fee and expense ratios of the Fund. To the extent further economies of scale may be realized by the investment manager and its affiliates, the Board believed the investment management and administrative fees provide a sharing of benefits with the Fund and its shareholders.

Proxy Voting Policies and Procedures

The Fund's investment manager has established Proxy Voting Policies and Procedures (Policies) that the Fund uses to determine how to vote proxies relating to portfolio securities. Shareholders may view the Fund's complete Policies online at franklintempleton.com. Alternatively, shareholders may request copies of the Policies free of charge by calling the Proxy Group collect at (954) 527-7678 or by sending a written request to: Franklin Templeton Companies, LLC, 300 S.E. 2nd Street, Fort Lauderdale, FL 33301, Attention: Proxy Group. Copies of the Fund's proxy voting records are also made available online at franklintempleton.com and posted on the U.S. Securities and Exchange Commission's website at sec.gov and reflect the most recent 12-month period ended June 30.

Quarterly Statement of Investments

The Fund files a complete statement of investments with the U.S. Securities and Exchange Commission for the first and third quarters for each fiscal year on Form N-Q. Shareholders may view the filed Form N-Q by visiting the Commission's website at sec.gov. The filed form may also be viewed and copied at the Commission's Public Reference Room in Washington, DC. Information regarding the operations of the Public Reference Room may be obtained by calling (800) SEC-0330.

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Franklin Templeton Funds

Literature Request. To receive a summary prospectus and/or prospectus, please call us at (800) DIAL BEN/342-5236 or visit franklintempleton.com. Investors should carefully consider a fund's investment goals, risks, charges and expenses before investing. The prospectus contains this and other information. Please carefully read a prospectus before investing. To ensure the highest quality of service, we may monitor, record and access telephone calls to or from our service departments. These calls can be identified by the presence of a regular beeping tone.

VALUE

Franklin All Cap Value Fund
Franklin Balance Sheet Investment Fund
Franklin Large Cap Value Fund
Franklin MicroCap Value Fund
Franklin MidCap Value Fund
Franklin Small Cap Value Fund
Mutual Beacon Fund
Mutual Quest Fund
Mutual Recovery Fund²
Mutual Shares Fund

BLEND

Franklin Focused Core Equity Fund Franklin Large Cap Equity Fund Franklin Rising Dividends Fund

GROWTH

Franklin DynaTech Fund Franklin Flex Cap Growth Fund Franklin Growth Fund Franklin Growth Opportunities Fund Franklin Small Cap Growth Fund Franklin Small-Mid Cap Growth Fund

SECTOR

Franklin Biotechnology Discovery Fund Franklin Global Real Estate Fund Franklin Gold & Precious Metals Fund Franklin Natural Resources Fund Franklin Real Estate Securities Fund Franklin Utilities Fund Mutual Financial Services Fund

GLOBAL

Franklin World Perspectives Fund Mutual Global Discovery Fund Templeton Global Opportunities Trust Templeton Global Smaller Companies Fund Templeton Growth Fund Templeton World Fund

INTERNATIONAL

Franklin India Growth Fund

Franklin International Growth Fund
Franklin International Small Cap Growth Fund³
Mutual European Fund
Mutual International Fund
Templeton Asian Growth Fund
Templeton BRIC Fund
Templeton China World Fund
Templeton Developing Markets Trust
Templeton Emerging Markets Small Cap Fund
Templeton Foreign Fund
Templeton Foreign Smaller Companies Fund
Templeton Frontier Markets Fund⁴

HYBRID

Franklin Balanced Fund
Franklin Convertible Securities Fund
Franklin Equity Income Fund
Franklin Income Fund
Templeton Emerging Markets Balanced Fund
Templeton Global Balanced Fund

ASSET ALLOCATION

Franklin Templeton Corefolio® Allocation Fund
Franklin Templeton Founding Funds Allocation Fund
Franklin Templeton Conservative Allocation Fund
Franklin Templeton Growth Allocation Fund
Franklin Templeton Moderate Allocation Fund
Franklin LifeSmart™ 2015 Retirement Target Funds
Franklin LifeSmart™ 2020 Retirement Target Funds
Franklin LifeSmart™ 2025 Retirement Target Funds
Franklin LifeSmart™ 2030 Retirement Target Funds
Franklin LifeSmart™ 2045 Retirement Target Funds
Franklin LifeSmart™ 2045 Retirement Target Funds
Franklin LifeSmart™ 2045 Retirement Target Funds
Franklin LifeSmart™ 2050 Retirement Target Funds
Franklin LifeSmart™ 2050 Retirement Target Funds
Franklin LifeSmart™ 2050 Retirement Target Funds
Franklin Templeton Global Allocation Fund
Franklin Templeton Multi-Asset Real Return Fund

FIXED INCOME

Franklin Adjustable U.S. Government Securities Fund⁶
Franklin Floating Rate Daily Access Fund
Franklin High Income Fund
Franklin Limited Maturity U.S. Government
Securities Fund⁶
Franklin Low Duration Total Return Fund
Franklin Real Return Fund
Franklin Strategic Income Fund
Franklin Strategic Mortgage Portfolio
Franklin Templeton Hard Currency Fund
Franklin Total Return Fund
Franklin U.S. Government Securities Fund⁶
Templeton Emerging Markets Bond Fund
Templeton Global Bond Fund
Templeton Global Total Return Fund

TAX-FREE INCOME⁷

National

Double Tax-Free Income Fund⁸ Federal Tax-Free Income Fund High Yield Tax-Free Income Fund Insured Tax-Free Income Fund^{9, 10}

Templeton International Bond Fund

Limited-/Intermediate-Term

California Intermediate-Term Tax-Free Income Fund Federal Intermediate-Term Tax-Free Income Fund Federal Limited-Term Tax-Free Income Fund New York Intermediate-Term Tax-Free Income Fund

State-Specific

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Alabama	Kentucky	New York
Arizona	Louisiana	(2 funds)
California	Maryland	North Carolina
(4 funds)10	Massachusetts	Ohio
Colorado	Michigan	Oregon
Connecticut	Minnesota	Pennsylvania
Florida	Missouri	Tennessee
Georgia	New Jersey	Virginia

INSURANCE FUNDS

Franklin Templeton Variable Insurance Products Trust¹¹

- 1. The fund is closed to new investors. Existing shareholders and select retirement plans may add to their accounts.
- 2. The fund is a continuously offered, closed-end fund. Shares may be purchased daily; there is no daily redemption. However, each quarter, pending board approval, the fund will authorize the repurchase of 5%–25% of the outstanding number of shares. Investors may tender all or a portion of their shares during the tender period.
- 3. Effective 6/3/13, the fund closed to new investors, with limited exceptions.
- 4. Effective 6/28/13, the fund closed to new investors. Existing shareholders and select retirement plans may add to their accounts.
- 5. Effective 5/1/13, the Franklin Templeton Retirement Target Funds changed their names to Franklin LifeSmart Retirement Target Funds. The funds' investment goals and principal investment strategies remained unchanged.
- 6. An investment in the fund is neither insured nor guaranteed by the U.S. government or by any other entity or institution.
- For investors subject to the alternative minimum tax, a small portion of fund dividends may be taxable. Distributions of capital gains are generally taxable.
- 8. The fund is closed to all new investments (other than reinvestment of dividends and capital gains distributions).
- 9. The fund invests primarily in insured municipal securities.
- 10. Effective at the close of market 3/1/13, Franklin Insured Tax-Free Income Fund and Franklin California Insured Tax-Free Income Fund closed to all new investments (other than reinvestment of dividends and capital gains distributions).
- 11. The funds of the Franklin Templeton Variable Insurance Products Trust are generally available only through insurance company variable contracts.

VALUE BLEND GROWTH SECTOR GLOBAL INTERNATIONAL HYBRID ASSET ALLOCATION FIXED INCOME TAX-FREE INCOM



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Semiannual Report and Shareholder Letter MUTUAL FINANCIAL SERVICES FUND

Investment Manager

Franklin Mutual Advisers, LLC

Distributor

Franklin Templeton Distributors, Inc. (800) DIAL BEN®/342-5236 franklintempleton.com

Shareholder Services

(800) 632-2301 - (Class A, C, & R6 (800) 448-FUND - (Class Z)

Authorized for distribution only when accompanied or preceded by a summary prospectus and/or prospectus Investors should carefully consider a fund's investment goals, risks, charges and expenses before investing. A prospectus contains this and other information; please read it carefully before investing.

To ensure the highest quality of service, telephone calls to or from our service departments may be monitored, recorded and accessed. These calls can be identified by the presence of a regular begoing tone.