Connection

Spring 2013 | A Newsletter for Sustainable Investors

PAX Pax World Mutual Funds | For Tomorrow®

INSIDE

Pax World Takes Hybrid Approach to Fossil Fuel Investing

By Pax World President and CEO Joe Keefe

A growing national movement focused on divestment from fossil fuels and cancelling the Keystone XL pipeline, spurred by the work of Bill McKibben and 350.org, have upped the ante in the debate over climate change. In the sustainable investment community, these new developments have helped re-kindle an important conversation about the role of fossil fuels in a sustainable investment portfolio.

As investors, there are essentially three approaches we can take to investing in fossil fuels:

Approach A is to invest in fossil fuels without any regard to climate change or other sustainability issues. This approach is unsustainable and irresponsible. It simply continues the status quo and fails to recognize the need for investors and capital markets to play a role in reducing carbon emissions and ameliorating climate change.

Approach B is to fully divest from fossil fuels. This approach is being urged by environmental activists and the student divestment movement.

Approach C is to partially divest from fossil fuels by taking a best-of-class approach to investing in energy companies, favoring those with stronger commitments to reducing carbon emissions and developing renewable energy. This option is embraced by the majority of investors in the sustainable investment community, where many regard a complete divestment from fossil fuels as impractical. Instead, a best-of-class approach—screening out the worst polluters while investing in companies that have made larger commitments to renewable energy—is coupled with shareholder engagement to prod energy companies to further reduce their emissions.

At Pax World, we employ a combination of approaches B and C. While we take a partial divestment/best-of-class/engagement approach for most of our funds—for example, we don't invest in coal—we also offer one fund, the Pax World Global Environmental Markets Fund (PGRNX), that completely avoids investing in fossil fuels.

Why do we generally take a hybrid approach to divesting from fossil fuels?

We have concerns about pursuing total divestment as an exclusive strategy because we are not convinced that these large multi-national companies will miss, or perhaps even notice, the small sliver of capital that is withdrawn. A second concern about divestment as an exclusive strategy is that when you sell your shares you lose your seat at the table and your voice, which can include engaging in dialogue with company management, voting proxies and supporting shareholder resolutions asking companies to disclose or reduce their carbon emissions. The role of activist investors in prompting change

CONTINUED ON BACK PAGE

30 Penhallow Street, Suite 400
Portsmouth, NH 03801

Editor Donna Marsh
Layout Dorset Norby Star

General Fund Information:
☎ 800.767.1729

Shareholder Account Information:
☎ 800.372.7827

www.paxworld.com

PAX003034 (7/13)

Insert#: 00093688

Global Board Diversity Still Has a Long Way to Go

By Heather Smith, Pax World Lead Sustainability Research Analyst

Despite numerous studies that underscore the nexus between board and management diversity and improved financial performance[1], overall trends on board diversity continue to be sobering. According to Governance Metrics International, between 2009 and 2011, the share of board seats held by women globally barely budged from 9.3% to 10.5% across over 4,300 companies in 45 countries[2].

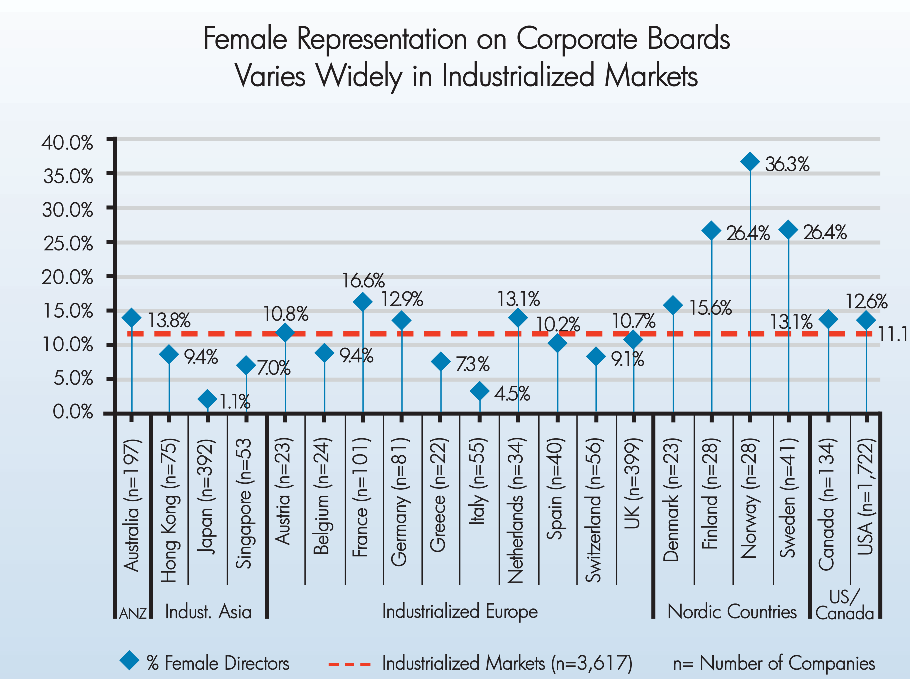
While the importance of board diversity has long been promoted by institutional investors, parliaments and regulatory bodies worldwide are, with increasing frequency, taking up the issue of gender diversity. This is a strong signal to companies that maintaining the status quo is unacceptable, and likely a reaction to the glacial progress in diversifying boards. In recent years, countries have launched a variety of policy initiatives to increase the number of women on corporate boards, including the adoption of gender quotas and voluntary targets, stock exchange listing standards and corporate governance guidelines requiring disclosure of board diversity policies, efforts and progress.

Europe has made notable efforts to achieve more diverse boards. Norway became the first to adopt a binding quota in 2002 with a law requiring that 40% of board members be women. Spain, Iceland, France, the Netherlands, Italy and Belgium have also adopted laws establishing gender quotas. In the United Kingdom, a commission recently set a goal of 25% women on FTSE 100[3] boards by 2015 and required listed companies to establish policies concerning boardroom diversity, including measurable objectives and annual disclosure of progress.[4] Germany's corporate governance code requires that companies design diversity goals for management and the board. Finland and Sweden have similar provisions in their corporate governance codes. Finally, the European Commission proposed a law in 2012 requiring that 40% of non-executive board seats be held by women at listed companies in Europe by 2020. The proposed law, which will affect nearly 5,000 companies, must be adopted by the European Parliament and EU member states.

Similar efforts to address board diversity are underway in Australia, New Zealand, Hong Kong, Malaysia, and even in the United Arab Emirates. In the United States, the Securities and Exchange Commission adopted a rule on enhanced proxy disclosure that requires, among other things, that companies disclose whether and how their nominating committees consider diversity in identifying board nominees. This increasing global visibility and discussion surrounding board diversity are acknowledgements that it is a material factor in business strategy and success and an indicator of good corporate governance.

Alongside governmental action, institutional investors and advocacy groups continue to play a key role in moving companies towards more diverse boards. With the formation of the Thirty Percent Coalition in 2011, institutional investors and national women's groups came together to press companies to

CONTINUED ON NEXT PAGE



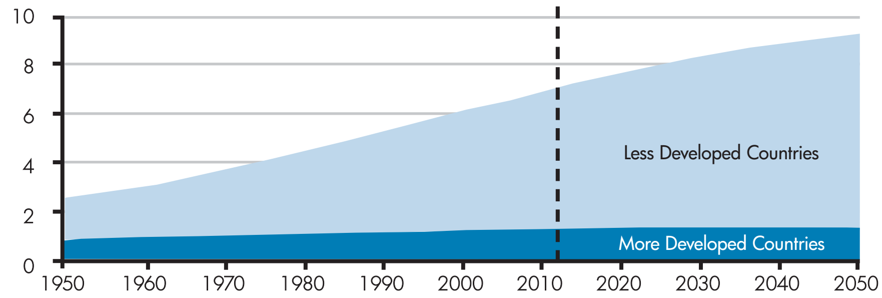
Norway is a leader among industrialized nations with regard to board diversity. The country became the first to adopt a binding quota in 2002 with a law requiring that 40% of board members be women. In recent years, Spain, France, the Netherlands, Italy and Belgium have also adopted laws establishing gender quotas.

Source: GMI Ratings' 2012 Women on Boards Survey, March 2012

Resource Optimization Creating Potential Environmental Investment Opportunities

Experts have debated for decades whether and when energy, water, food and materials supplies would fall short of meeting the needs of the world's rising population. Compelling evidence now exists that we have reached a tipping point beyond which the availability and/or price of these resources is likely to limit or restrict access without significant improvements in the efficiency of supply and use.

Rising Populations, Affluence Increase Pressure on Natural Resources



Populations in developed countries are relatively static compared to rapid growth in less developed countries.

Source: United Nations Population Division, "World Population Prospects, the 2008 Revision"; Population Reference Bureau

Indeed, rapid population growth and rising affluence are placing increasing demands on the world's finite natural resources. By 2050, the world's population is expected to reach 9.5 billion people—almost a 50% increase over today's population[1]. This growth will be centered mainly in less developed countries, many of which are already resource-challenged. At the same time, wealth is being created at an unprecedented level. Developing countries in particular have vastly increased demand for resources to support their growth.

At this time of rapid population growth, rising affluence in emerging markets, and ever-increasing demand for scarce natural resources, a strong case can be made for investing in environmental markets. Environmental markets today are comprised of some 1,400 companies with annual revenues in excess of $500 billion.

The investment community has traditionally focused on supply expansion, but today efficiency solutions are just as important, if not more so. The Pax World Global Environmental Markets Fund (PGRNX) invests in environmental and resource optimization markets and seeks to take advantage of this rapidly accelerating demand for efficiency solutions in the areas of alternative energy and energy efficiency; water infrastructure and technologies and pollution control; waste management and technologies; and environmental support services.

For more information on the Fund or to download the white paper, "Resource Scarcity and the Efficiency Revolution" visit www.paxworld.com. ■

[1]United Nations Population Division, "World Population Prospects, The 2008 Revision" taken from the Population Reference Bureau website.

Equity investments are subject to market fluctuations, the fund's share price can fall because of weakness in the broad market, a particular industry, or specific holdings. Emerging market and international investments involve risk of capital loss from unfavorable fluctuations in currency values, differences in generally accepted accounting principles, economic or political instability in other nations or increased volatility and lower trading volume.

improve their board diversity. The Coalition, of which Pax World is a founding member, has set a goal of women holding 30% of board seats across public companies by the end of 2015. In June 2012, the Coalition, representing approximately $1.2 trillion in assets, wrote to the 41 companies in the S&P 500 Index[5] that do not have any women on their boards. The initiative resulted in responses and dialogues with 16 companies. In February 2013, the Coalition launched a similar engagement with 127 companies in the Russell 1000 Index[6] that do not have any women on their boards and will continue to engage in dialogues and follow-up on company progress. ■

[1]See, e.g., Catalyst, "The Bottom Line: Corporate Performance and Women's Representation on Boards," 2007; Catalyst, "The Bottom Line: Connecting Corporate Performance and Gender Diversity," 2004; Roy D. Adler, "Women in the Executive Suite Correlate to High Profits," European Project on Equal Pay; Desvaux, Devillard-Hoellinger and Meany, "A Business Case for Women," The McKinsey Quarterly, September 2008; Professor Michel Ferrary, "When Gender Diversity Protects Stock Prices From the Crash," Ceram Business School, 2009.

[2]"2012 Women on Boards Survey," Governance Metrics International, April 4, 2012.

[3]The FTSE 100 Index is a market-capitalization weighted index representing the performance of the 100 largest UK listed blue chip companies, which pass screening for size and liquidity.

[4]Davies Commission, "Women on Boards 2011," February 2011.

[5]The S&P 500 Index is an unmanaged index of large capitalization common stocks. One cannot invest directly in an index.

[6]The Russell 1000 Index measures the performance of the 1,000 largest companies in the Russell 3000 Index. One cannot invest directly in an index.

Shareholder Corner

Help Save a Tree; Sign-up for E-Delivery

It's easy to sign-up today. Go to www.paxworld.com and Log In to Online Account Access. Choose Electronic Delivery from the Profile Maintenance menu on the left, enter your email address and select your delivery method for Account Statements, Daily Confirmation Statements, Prospectuses, Annual and Semi-Annual Reports, Tax Forms and Proxy Materials. Investor Service Representatives are available at 800.372.7827 Monday – Friday 8am – 6pm ET to answer any questions you have about E-delivery. ■

FOSSIL FUEL CONTINUED FROM FRONT PAGE

should not be discounted. But in order to file shareholder resolutions, or to engage companies in these types of dialogues, you have to own shares. Thus, a complete divestment approach, while a necessary component to a broader strategy, strikes us as insufficient as an exclusive strategy.

I do believe that a divestment strategy, if widely embraced, could have the effect of shaming companies, putting pressure on them to be more responsive, to embrace sustainability strategies, and to change. Thus, it clearly has its place within a range of strategies that need to be deployed to marshal investment capital to be part of the solution on climate change. It's just insufficient as an exclusive strategy—which, again, is why Pax World pursues a combination of strategies.

Thus, in addition to advocating divestment, I would encourage students to engage colleges and universities on taking at least some positive steps to begin greening their investment portfolios in a meaningful way. They can do this by allocating a portion of assets to fossil-free funds embracing Approach B and/or partial divestment/best-of-class investment strategies under Approach C.

In this regard, the flimsy rebuttal we sometimes hear, that an endowment's fiduciary duty means that its only obligation is to maximize return, regardless of the consequences or externalities, is utter nonsense. There is now a substantial body of research underscoring that companies with better environmental performance also tend to enjoy better financial performance. It is ignoring these issues, rather than integrating them, which most likely constitutes a breach of fiduciary duty.

Every college and university, every foundation, every endowment, every institution and each and every individual who claims to be concerned about climate change, can easily take steps to assure that their investments are in alignment with those stated concerns. To accept the science on global warming, and to be committed to doing something about it, but to invest one's resources in a way that wholly ignores that imperative, is the mother of all inconsistencies.

"Be the change," Ghandi said. What the new student movement has begun to ask of colleges and universities, we must all ask of ourselves so that our investments are no longer in conflict but are aligned with our values. At Pax World, we believe that sustainable investing needs to be a core component of any comprehensive strategy to address climate change. ■

This article is an abbreviated version of remarks given by Pax World President and CEO Joe Keefe to the student environmental action coalition campaign to divest University of New Hampshire's endowment from fossil fuel companies. His complete remarks can be found at www.paxworld.com/about-pax-world/viewpoint.