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ESG Goes Mainstream

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Pax World is recognized as a leader in Sustainable Investing—the full integration of environmental, social and governance (ESG) factors into investment analysis and decision making. Pax World was among the first investment managers to combine rigorous financial analysis with equally rigorous ESG analysis in a defined, systematic and repeatable portfolio management process. Now, an abundance of evidence indicates that the broader investment management community is embracing Sustainable Investing principles.

Why does this matter? As investors increasingly see specific sustainability issues as being important, more information will be available about these issues; and more analysts will cover them. Julie Gorte, Ph.D., Pax World senior vice president for Sustainable Investing explains: “As climate change became a mainstream investment issue, we started seeing more and more sell-side reports and mainstream news reports that talked about greenhouse gas emissions and which companies would thrive and

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Is a Market Recovery Underway?

A Mid-Year Economic Update with Pax World Chief Investment Officer Chris Brown

After a dismal market environment in 2008—one of the worst years in decades for global financial markets—investors were more confident in the economy in the second quarter of 2009, as evidenced by the S&P 500 Index rising 15.93% in the three-month period ended June 30, 2009—the best quarterly percentage gain for the index since 1998.¹ We recently talked with Pax World Chief Investment Officer Chris Brown about some of the economic factors he sees impacting markets in 2009 and beyond.

What factors may be contributing to a market turnaround in the second quarter?

An increase in consumer confidence in the early part of the year and a combination of

thawing credit markets and cheap equity values appear to have been the biggest drivers of the recent strong market rally.

Economic indicators such as consumer confidence, housing sales and manufacturing output offer mixed signals with respect to the state of the U.S. economy. What are the primary economic indicators you look at, and what do they tell you right now?

Here in the United States, the health of the consumer is the most important indicator for where our economy is headed. Although consumer confidence rebounded earlier this year, we are starting to see signs of weakness as higher unemployment and lower housing prices weigh heavy in the minds of consumers. The recent ISM (Institute for

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Supply Management) and PMI (Purchasing Managers Index) surveys have shown some improvement, although we would like to see increased consumer demand, rather than restocking of depleted inventories. We continue to closely monitor unemployment, payroll and consumer confidence in order to gauge the condition and sentiment of the consumer. Overall, we are seeing mixed signs in some of the key economic indicators, but it appears that some of the negative reports are showing a slowing pace of decline, which could potentially point to a bottom for the recession and ultimately lead to a slow economic recovery.

Despite an aggressive coordinated global monetary stimulus policy, we have yet to see inflation rise. What is your outlook on this?

Since the consumer continues to be the largest driver of growth for gross domestic product (GDP), a key

economic indicator, in the United States, I believe inflation should remain muted for the foreseeable future as Americans continue to pay off their debts and save. We expect muted growth for the rest of the world with a few exceptions such as China and some other emerging markets. While the health of some emerging economies has been surprisingly resilient, global inflation should remain in check as many of the developed countries struggle with low economic growth.

What is your approach to finding investment opportunities given the challenging market environment?

Our Sustainable Investing approach—the combination of rigorous financial analysis with equally rigorous environmental, social and governance (ESG) analysis—helps us identify key investment themes and companies that we believe offer better long-term investments for our shareholders. Typically, significant opportunities

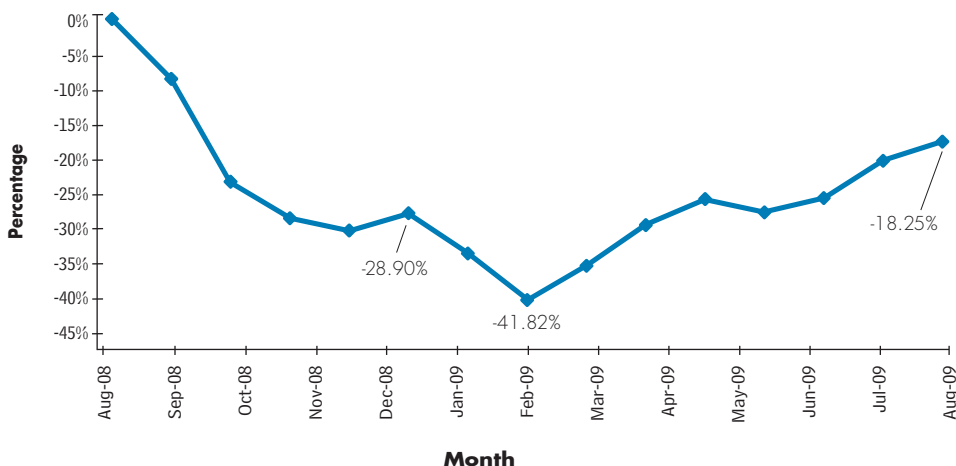
present themselves when markets are in disarray, so we believe now, more than at any time in recent history, attractive opportunities exist in renewable energy, water, health care, infrastructure (spending) and “smart grid” technology.

What can investors learn from the recent market crisis?

Some themes have emerged from the recent market crisis. First, I believe executive compensation will require more scrutiny, not just by regulators, but by investors themselves. Investors are responsible for the election of each company’s board of directors who have oversight of a company’s executive compensation plans. For years there was a substantial disconnect between executive compensation and the creation of long-term shareholder value. Many executives took excessive risk with respect to their businesses in order to achieve short-term bonuses/compensation targets at the expense of long-term, sustainable shareholder value.

ONE-YEAR RETURNS FOR THE S&P 500 INDEX FROM AUGUST 2008 TO AUGUST 2009

2009 has provided some positive signs that a market recovery may be underway.



From 08/31/08 to year-end 12/31/08, the S&P 500 Index declined -28.90%. The S&P 500 Index continued its decline to its lowest month-end point in the 1-year period, -41.82% as of Feb 2009. Upward movement since lowest month-end point in 1-year period, the S&P 500 Index increased 23.57% from month-end Feb 2009 to month-end Aug 2009.

The S&P 500 Index is an unmanaged index of large capitalization common stocks. One can not invest directly in an index. Past Performance is not a guarantee of future results.

In addition, I think a simpler, yet stronger, code of conduct as well as better transparency will be necessary to ensure a liquid securities market across all asset classes. At present, there are too many codes of conduct covering various job functions, which has made it very confusing for regulators and those being regulated.

Finally, I believe that confidence in the financial system as a whole needs to be strengthened in order for investors to feel comfortable with the markets. While some confidence has returned, it will likely be a long process before investors’ comfort level with the market is fully restored.

¹S&P 500 Index. Based on average annual returns for the S&P 500 Index for the period December 31, 1998 to June 30, 2009.

Mercy Corps One Table Campaign: Fighting Hunger by Investing in Women

Myint is a school teacher in Myanmar's Irawaddy Delta who is diversifying her vegetable garden to improve her family's nutrition and earn tuition money for her eldest son. Dafroza is a community leader in the Congo who is teaching women how to make more efficient cooking stoves to help them increase and improve their diets and survive inhospitable displacement camps. And Kanthi is a widowed rice farmer in Sri Lanka who is learning a new method of cultivation that will reduce her reliance on expensive fertilizer and increase her harvest at the same time.

Around the world, Mercy Corps, a leading humanitarian relief organization based in Portland, Oregon, is investing in women like Myint, Dafroza and Kanthi, recognizing they're the key to fighting hunger.

Shockingly, in the five minutes it takes to read this article, 85 people will die because they don't have enough to eat.¹ What's more, chronic hunger leads to opportunistic diseases, women dying during pregnancy, underweight babies facing lifelong health problems, generations of impoverished families, and environmental damage from desperate farmers simply trying to feed their families.

But hunger is a solvable problem. Mercy Corps is confident that investing in women is one of the smartest ways to end hunger—and improve the well-being of entire families. That's because when a woman succeeds in school, farming or business, she provides food, education and health care to her family. Her own health and well-being improve. She gains confidence and ingenuity, and the entire community benefits.

Believing in the power of investing in women, Mercy Corps recently launched a new campaign to fight hunger. The campaign is called "One Table", named so because Mercy Corps believes global hunger is a shared problem and that we must come together to solve it. And that all of us—whether we live in Connecticut or the Congo—have something to bring to the table. Here's how you can help:

- **Voice** Urge Congress and President Obama to support the Roadmap to End Hunger, a comprehensive global strategy for the United States, led by Mercy Corps and other international organizations.
- **Donations** Help women feed their families by making a contribution or participating in the Pax World Global Citizen Program, which allows investors in the Pax World Mutual Funds to designate a portion of their investment earnings (dividends and/or capital gains) to support Mercy Corps' programs around the globe.
- **Host a party** Host a potluck fundraiser at your house to support Mercy Corps' efforts to fight hunger by investing in women.
- **Connect with friends and family** Use Facebook, YouTube and Twitter to keep up with Mercy Corps' One Table campaign, and to tell your friends and family about global hunger issues and what they can do to help end them.

Millions of women—like Myint, Dafroza and Kanthi—are already at the table, doing their part. Standing with them are hundreds of Pax World shareholders who support the work of Mercy Corps through the Pax World



After the May 2008 cyclone in Myanmar, Mercy Corps helped Myint and 300 other families in her village establish "kitchen gardens" by providing seeds, gardening tools and technical training. Throughout the developing world, 60 to 80% of the food is grown by women. Photo by Miguel Samper for Mercy Corps

Global Citizen Program. Through this program, Pax World shareholders can amplify the social benefits of their investments by supporting humanitarian relief efforts, peace and reconciliation initiatives, and sustainable development projects around the globe.

We all have something to contribute. What can you bring to the table? Learn more at onetable.mercycorps.org ■

¹Source: *State of Food Insecurity in the World*, FAO, 2008.



Kanthi, a widow with two young daughters, learned how to grow twice as much rice paddy on half an acre of land. Photo by Thatcher Cook for Mercy Corps

which would be hurt by a carbon trading regime or mandatory emissions limitation.”

In addition, Gorte believes increased investor interest helps improve corporate transparency and the disclosure of ESG information, thereby allowing shareholders to pressure companies to improve their sustainability practices. “Simply put, we think increased attention to sustainability in investment processes helps drive change,” says Gorte. “Ultimately the adoption of these sustainability practices offers the potential for improved long-term investment performance.”

A few examples that reveal that Sustainable Investing principles have entered the mainstream:

- The world’s largest stock exchange, NYSE Euronext, has announced that it will begin to make ESG information available on 2,800 of the world’s largest companies.¹
- Bloomberg recently announced that it will soon begin to distribute publicly available ESG data on 2,000 to 3,000 companies through its 250,000 data terminals worldwide.²
- Fidelity Investments has added ESG performance ratings to its stock research offering.³
- The CFA Institute Centre for Financial Market Integrity, the global policy authority on professional and performance standards, financial reporting, and capital markets, launched its 2008 Environmental, Social, and Governance Factors at Listed Companies: A Manual for Investors, last year to assist investors in understanding how a company deals with ESG issues.⁴

Kurt Schacht, CFA, managing director of the CFA Institute Centre stated, “Once considered ‘fringe issues,’ these topics [ESG] are now part and parcel of the metrics used by investment professionals to analyze and value the public companies they invest in.”⁴

“Ultimately the adoption of these sustainability practices offers the potential for improved long-term investment performance.”

- More than 500 asset owners, investment managers and professional service providers from around the world have become signatories to the Principles for Responsible Investment, a global investor initiative designed to provide a framework for better integration of ESG issues into mainstream investment practices. In addition to Pax World, the group includes such prominent organizations as CalPERS and CalSTRS, the New York City Employees Retirement System, TIAA-CREF, USB Global Asset Management and TD Asset Management.⁵
- A recent report from Mercer, a leading global provider of investment consulting services, found that 39% of the investment managers who have signed onto the Principles for Responsible Investment initiative have already incorporated ESG issues into their decision-making process for developed market equities. The Mercer study, which was published in July 2009, examined the adoption of ESG factors in the investment

decision making process within the broader financial markets. According to the study, “In many cases, ESG performance can directly impact a corporation’s ability to expand to new markets, attract knowledgeable and skilled workers, and access key resources—important factors in considering a corporation’s prospects for future financial performance.”⁶

In the report Mercer states that the incorporation of ESG criteria into investment analysis is becoming more common; this is a trend the firm predicts will continue in the future. In addition, it recognized that those investment managers that currently incorporate ESG analysis into their processes have certain advantages over those who don’t, as they “may be able to better identify attractive investment stocks before the broader market does.”⁶

Gorte believes that investors have a unique power in promoting the benefits of including ESG into investment analysis. “If we all recognize that sustainable corporations are better investments, those companies could trade at a premium,” explains Gorte. “The more investors incorporate sustainability—and the more they accept that the long term is at least as important as the short term—the more sustainable we will be, in nearly every way.” ■

¹New York Stock Exchange – “New Solutions to Help NYSE-Listed Companies Enhance Corporate Governance and Transparency,” May 19, 2009.

²Business Week – Mindy Libber, “Companies Come Clean on Climate Change,” June 3, 2009.

³Fidelity.com.

⁴CFA Institute Centre for Financial Market Integrity, “New ESG Manual from CFA Institute Centre Helps Investors Evaluate Environmental, Social and Governance Factors,” June 25, 2008.

⁵Principles for Responsible Investment, www.unpri.com, May 31, 2009.

⁶Mercer, “Why Consider ESG Factors? The Case for ESG Integration,” July 14, 2009.

Pax World Co-Leads Small-Cap Sustainability Reporting Initiative

Working to Standardize Sustainability Reporting Among Russell 2000 Firms

Small-cap companies in the Russell 2000 Index comprise slightly less than eight percent of the market capitalization of the investable U.S. equity markets.¹ Yet Pax World research has found that it is not uncommon for companies in this space to provide virtually no disclosure of their environmental, social and governance (ESG) programs or performance. This is in stark contrast to large-cap companies where ESG reporting has become more mainstream, with 80% of the world's 250 largest companies having reported on ESG performance in 2007, up from 50% in 2005.² There are a number of small-cap companies engaged in activities that can have far-reaching environmental and social impacts, including oil and gas exploration and production and utilities and industrial manufacturing, for which sustainability reporting plays a key role in communicating to investors and stakeholders how industry-specific ESG risks are being managed.

In an effort to make sustainability reporting the norm, rather than the exception, among companies in the Russell 2000 Index, Pax World and Walden Asset Management are co-leading the Small-Cap Disclosure Initiative. The coalition of 10 asset managers and ESG ratings organizations has sent letters to more than 100 small-cap companies in high-impact sectors such as industrials, energy and utilities, urging them to take steps to increase ESG disclosure and requesting they share their plans for future sustainability reporting.

Many small-cap companies that have positive ESG stories to tell are often intimidated by the scope of full sustainability reporting. The members of the coalition have offered to assist these companies as they begin the process of assessing and reporting on sustainability.

We recognize the challenges small-cap companies face with sustainability reporting. For example, unlike their larger peers, it is common for employees of small-cap firms to wear many hats. Often, there is no one person solely responsible for sustainability concerns. We also believe sustainability disclosure can take several forms and that taking steps to increase transparency now may benefit these companies in the long run as we anticipate even greater demand for environmental, social and governance data by investors and stakeholders in the future.

Pax World believes this is an important first step in forming constructive dialogues and partnerships with small-cap companies as they move towards improved ESG disclosure. The coalition has plans for continued engagement with its first group of 100 companies, in addition to expanding the initiative to include companies in the remaining seven sectors of the Russell 2000 Index. ■

¹Russell Investments. http://www.russell.com/Indexes/characteristics_fact_sheets/US/Russell_2000_Index.asp.

²Social Investment Forum, "2007 Report on Socially Responsible Investing Trends in the United States".



Labor Issues Take on Increased Importance

For many Americans out of work this year, finding employment has been a most challenging task. And securing a job with a company with a commitment to its employees might seem like an unattainable dream. But the reality is that labor practices are critically important now as the U.S. struggles to move forward out of one of the worst economic crises in decades.

Work is the primary route out of poverty. For the nearly 10% of Americans who are currently counted as unemployed, and nearly 800,000 "discouraged workers" who would like to work full-time but have not looked for work because they believe none is available, that path back into poverty is frighteningly clear.¹ While the United States is considerably better off than most other parts of the world, we also know that a jobless recovery won't be a real recovery until the majority of those who want work can find it.

Every company depends upon its workers for its success. Academic studies demonstrate that good labor practices are more than compensated for by financial outperformance. A

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Shareholder Corner

Study Finds Americans Anticipate Retiring Later in Life

A study released this year by the Employee Benefits Research Institute (EBRI) found that the recession has changed the retirement expectations of the vast majority of Americans. According to the study, a record-low 13 percent of Americans surveyed say they are very confident they will have enough money to live comfortably in retirement. Among workers, those feeling very confident about retirement has tumbled by one-half in the last two years.¹

In light of the challenging economic environment, now is an ideal time to review your investments and ensure your plans are on track toward a comfortable retirement. Many financial advisors recommend taking advantage of any company-sponsored retirement plan that offers a matching benefit.

Once the requirement is met for any available match, it may be wise to consider investing in or increasing your contributions to an existing IRA to maximize your retirement savings potential.

There are two types of IRAs available to investors:

Traditional IRA: Money invested in a Traditional IRA can be fully or partially deductible, depending on your situation. Eligible contributions allow you to take an immediate tax deduction, which can lower your adjusted gross income (AGI). The invested money is taxed when withdrawn at retirement age, and there are penalties for early withdrawal in most cases.

Roth IRA: Money invested in a Roth IRA is non-deductible, but distributions made during retirement age are tax exempt. As with the

Traditional IRA, early withdrawals typically trigger penalties.

Keep in mind that there may be certain tax or eligibility restrictions for Traditional or Roth IRAs based on your age, income, filing, and marital status. The investment limit for 2009 is \$5,000 if you are under age 50 and \$6,000 if you are over age 50.

The information presented here does not constitute tax advice. Always consult your personal tax advisor before making any tax-related investment decision.

Pax World offers a full range of Sustainable Investing mutual funds. For information visit www.paxworld.com or call a Shareholder Services representative at 800.767.1729. ■

¹Employee Benefit Research Institute (EBRI), 19th Annual Retirement Confidence Survey (RCS), April 2009.

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2006 study² found that there are financial rewards for good workplace relations, and concluded that companies appearing on *Fortune Magazine's* annual 100 Best Companies to Work For list “significantly outperform a size- and industry-matched control group on all measures.”³

Sadly, there is little reporting on workplace practices. Investors are usually unable to find out how committed a company is to its employees until there is a disaster. This is one of the reasons that Pax World has been a

signatory to two letters to the Securities and Exchange Commission urging it to consider requiring greater environmental, social and governance (ESG) disclosure.⁴ Pax World is also a participant in an investor engagement under the Principles for Responsible Investment, encouraging companies to provide additional disclosure to investors on workplace rights and implementation of core International Labour Organization labor conventions.

There is no substitute for a committed, talented workforce. At Pax World, we

believe that, particularly in today's challenging economic environment, a company's commitment to worker satisfaction, safety and equal opportunity are strong indicators of better-managed companies. ■

¹U.S. Department of Labor, Bureau of Labor Statistics, “The Employment Situation”, August 2009”.

²Olubunmi Faleye and Emery Trahan, “Is What's Best for Employees Best for Shareholders?” College of Business Administration, Northeastern University, May 2006.

³Olubunmi Faleye and Emery Trahan, *op. cit.*, p. 3.

⁴The two letters are from the Social Investment Forum (which is posted at http://www.socialinvest.org/documents/ESG_Letter_to_SEC.pdf) and the Investor Network on Climate Risk, which is posted at <http://www.ceres.org/Document.Doc?id=478>.

Past performance is no guarantee of future results.

Important Disclosures Please Read

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The principal risks of investing in the Pax World mutual funds include (i) price volatility, (ii) credit risk (the possibility that the issuer of a bond will be unable to make interest payments and/or repay the principal on its debt), (iii) interest rate risk (the risk that the price of bonds and the value of the fund can decrease when interest rates rise), (iv) risks associated with foreign security investments (such as the risks of political or economic instability in the country of the issuer, the possibility of the imposition of exchange controls, and the risk of currency fluctuations), (v) leverage risk, (vi) risks associated with sustainable investing, (vii) management risk and, in general, (viii) the risk of losing money by investing in the funds.

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