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DON'T LET TAX SEASON SNEAK UP ON YOU

SHAREHOLDER CORNER



2011—A Year of Renewed Commitment and Enthusiasm

A Year-End Letter from Joseph F. Keefe, President and CEO

2010 was quite a year—a continued recession, a recovering market, a historic election. A lot happened. At the same time, I can't help but reflect on how much *didn't* happen. Although Congress did pass modest financial reform legislation—some would argue that it didn't go far enough—some in Congress are now talking about de-funding it or repealing it outright. And while Pax World labored for years to win shareholder access to the corporate proxy ballot, which was included in the Dodd-Frank reform bill, the Chamber of Commerce recently filed a lawsuit to block its implementation. Meanwhile, our nation still lacks a coherent

national energy policy and has made little or no progress on curbing carbon emissions to address climate change.

Under the circumstances, it seems fair to ask whether we have learned any lessons at all from the great financial crisis of the past few years, or whether we are ready to address an ongoing sustainability crisis that includes not only climate change but issues of resource scarcity and ecological imbalance that truly threaten our planet's future. We seem increasingly incapable of addressing our most urgent national priorities—from financial reform to energy to the national debt to a host

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Talent, Gender and Finance— A Winning Combination

by Julie Gorte, Ph.D., Senior Vice President, Sustainable Investing

Corporate approaches to gender equality and women's empowerment, along with other information on how corporations treat stakeholders, can shed light on the quality of management. While women's empowerment is far less well-studied than many other environmental and social factors in the literature on finance, the academic and financial studies that have studied the effect of gender on financial and economic performance generally show that women's empowerment is positively and significantly correlated with increased financial value. Pax World recently completed a literature review

of the academic studies linking gender diversity and financial performance, and found that gender diversity isn't just socially desirable—it has financial value as well.

The majority of the academic studies we reviewed show that having women among managers or on boards is positively and significantly correlated with positive financial performance. Not all academic studies show this, of course; some find that there is no statistical relationship between gender equality (particularly board diversity) and

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A Closer Look at Small-Cap Investing

An interview with Nathan Moser, CFA, Pax World Small Cap Fund Portfolio Manager

In volatile markets like today's, investors often shy away from investing in small companies in favor of large companies, which they believe may involve less risk. Indeed, small-cap companies, those with market capitalizations typically between \$100 million and \$3 billion, have historically exhibited increased share price fluctuations during uncertain markets when compared to large-cap companies. However, often overlooked in this comparative analysis is the outperformance of small-caps versus large-caps during these same time periods. *Connection* talked with Nathan Moser, CFA, portfolio manager of the Pax World Small Cap Fund (PXSCX), about the role small-caps can play in a well-diversified portfolio.

What should investors consider when evaluating small-cap investments?

In my opinion, investors must first consider the risk and return trade-offs associated with small-cap investments, specifically the higher share price volatility that has accompanied the segment's outperformance when compared to large-cap companies. Analysis of the Russell 2000 Index¹ (which is comprised of small-caps) and the S&P 500 Index² (which is comprised of large-caps) for the period 12/31/99 through 12/31/09 offers insights on the historical risk versus return trade-offs associated with small-cap investing. On one hand, the Russell 2000 Index has a higher standard deviation* (a measure of share price volatility) of 21.46, versus the S&P 500 Index's standard deviation of 16.07.

However, small-cap investors were well compensated in terms of returns for the higher level of risk during that period. Small-caps, as measured by the Russell 2000 Index, outperformed large-caps, as measured by the S&P 500 Index in 8 of the past 10 years and by more than 50% (cumulative) over that period.³ In fact, during 2008—one of the worst years in stock market history—small-caps outperformed large-caps by more than 3% as investors learned that large, often well-known companies can suffer dramatic losses.³ It's a great example of the potential diversification benefit small-caps can provide.

What are your thoughts about investing in small-caps in today's environment?

Small-cap performance has historically been highly influenced by economic cycles. Performance has been best when the economy has emerged from a recession. Conversely, performance has lagged when economic growth has deteriorated in the latter stages of a recovery. Our current economic environment is characterized by slow but positive gross domestic product (GDP) growth. Many professional investors, including myself, do not believe we are going to slip back into a recession. In this environment, strong growth becomes scarce and investors may tend to find companies that can grow quickly—typically smaller companies—quite attractive.

I also believe recent increased merger and acquisition activity within the small- to mid-sized market will continue to benefit small-cap investors. As economic growth remains tepid and interest on cash yields slightly above zero, management teams are increasingly

OVER THE LAST TEN YEARS, SMALL-CAPS OUTPERFORM LARGE-CAPS

As depicted in the cumulative return chart below, small-caps (as represented by the Russell 2000 Index) have consistently outperformed large-caps (as represented by the S&P 500 Index) for the 10-year period ended 11/30/10.



Source: Factset
The Russell 2000 Index is an index that measures the performance of the 2,000 smallest companies in the Russell 3000 Index. The S&P 500 Index is the Standard & Poor's composite index of 500 stocks, a widely recognized, unmanaged index of common stock prices. Investors cannot invest directly in an index.
Past performance is no guarantee of future results.

looking to mergers and acquisitions to deploy cash and drive growth. Due in large part to cost cutting and reduced capital expenditures, cash continues to build on corporate balance sheets with constituents of the Russell 2000 Index amassing cash exceeding \$250 billion, representing more than 15% of total market capitalization.⁴ I believe that small, high-quality companies are prime targets for acquisition, and command premium pricing as they are considered easier to integrate into existing business models versus larger companies.

Finally, given the U.S. government's recent economic stimulus and monetary policies designed to boost the economy, I expect inflationary pressures to increase to a level where the Federal Reserve may contemplate tightening policy at some point in the future. Small-caps have historically performed

well during periods with inflationary pressures such as the 1970's, when small-caps outperformed all other assets classes except gold.⁵

What is your small-cap investment philosophy?

I believe the key to delivering superior long-term investment performance in small-caps is to identify well-positioned, high-quality, growth-oriented companies. The Pax World Small Cap Fund takes what I believe to be a conservative view to stock selection, favoring companies with strong management teams with proper compensation incentives; product(s) or services with the ability to grow through all phases of the business cycle; and high levels of profitability. In addition, the Fund seeks to invest in companies with strong balance sheets with steady free cash flow generation, which allows companies to self-fund their growth. By

investing in companies I believe are reasonably-valued with favorable industry dynamics such as rational pricing, concentrated market shares, and reduced government influence, I believe the Fund is well-suited for today's slow-growth economic environment. ■

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. Funds that emphasize investments in smaller companies generally will experience greater price volatility.

¹The Russell 2000 Index is an index that measures the performance of the 2,000 smallest companies in the Russell 3000 Index.

²The S&P 500 Index is the Standard & Poor's composite index of 500 stocks, a widely recognized, unmanaged index of common stock prices.

³Source: Factset.

⁴Source: Bank of America, Merrill Lynch, Factset.

⁵Source: Proprietary research of Pax World.

*Standard deviation is a statistical measure of the extent to which returns of an asset vary from its average.

CFA is a trademark owned by CFA Institute.



"The majority of the academic studies we reviewed show that having women among managers or on boards is positively and significantly correlated with positive financial performance."

financial performance, and a few have found a negative correlation. But life is full of exceptions. The bottom line is that the majority of the literature we studied supports the case that women can bring unique strengths to corporate management that are reflected in positive financial performance.¹

Our research found that financial outperformance is strongest when women are included in executive management, and to a lesser extent on boards. The most notable finding in terms of how women contribute is through more careful and conservative financial management, and more robust oversight of corporate governance. Does this mean that any company can necessarily do better just by including women among its managers and on its board? Of course not. The salient point is not that women are better at managing corporations than men. Rather, it is that groups that include both genders tend to work differently than homogeneous ones, and in ways that generally contribute to better corporate governance.

At Pax World, we believe that women have a place at all corporate tables. This is not only the guiding philosophy of the Pax World Global Women's Equality Fund; it is also reflected in Pax's own management team: half of our management committee is female, as are half of our portfolio managers and sales representatives. To learn more, visit paxworld.com/womensequality. ■

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.

¹See, for example: Bill Francis, Iftekhar Hasan, Jong Chool Park and Qiang Wu, "Gender Differences in Financial Reporting Decision-Making: Evidence from Accounting Conservatism," n.d. Posted at <http://ssrn.com/abstract=1471059>.

²See, for example: Réal Labelle, Rin Makni Gargouri and Claude Francoeur, "Ethics, Diversity Management and Financial Reporting Quality," September 2009. Posted at <http://ssrn.com/abstract=1471332>.

Pax World and 85 Broads Join Forces to Promote Gender Equality

Partnership will support initiatives to empower and inspire women

Pax World recently joined forces in a collaborative partnership with 85 Broads (www.85broads.com), a global network of 25,000 visionary women in over 90 countries who passionately believe in using their intellect and ambition to change the game for all women globally.

Fundamental to Pax World's approach is the belief that the status and role of women is an excellent clue to a company's growth potential and that empowering women and promoting gender equality is good for a company's bottom line and good for investors.

The elements of the Pax World-85 Broads partnership will include collaboration of resources and content around the promotion of gender equality through investment practices; developing events and educational opportunities to connect, empower and inspire women; and other related initiatives.

"We are very excited about our partnership with Pax World," said Janet Hanson, Founder and CEO of 85 Broads. "Pax World's initiatives to promote gender equality, as well as its Sustainable Investing approach, are a perfect fit for us strategically."

Hanson and Jacki Zehner, Vice Chair of the Women's Funding Network and



"Pax World's initiatives to promote gender equality, as well as its Sustainable Investing approach, are a perfect fit for us strategically."

JANET HANSON,
FOUNDER AND CEO OF 85 BROADS

member of 85 Broads, have joined Pax World's Women's Advisory Council, which is comprised of nationally-known leaders and experts on women's issues. The Council assists Pax World in its efforts to advance women and gender equality through various investment initiatives.

85 Broads was originally founded in 1997 by Hanson as an exclusive network for current and former women employees of Goldman Sachs who worked at 85 Broad Street, the firm's former New York, NY, headquarters. Today, trailblazing women from all corners of the globe and from all career paths are invited to join this unique global network.

In addition to its Global Women's Equality Fund (PXWEX), Pax World includes gender criteria in the sustainability analysis it applies to all its no-load mutual funds and also actively promotes gender equality and women's empowerment through an array of advocacy initiatives.

"At Pax World, we see gender equality as an investment concept," said Pax World President and CEO Joe Keefe. "The smartest companies in the world, in our view, are those that empower and advance women, and we want to invest in those companies."

For more information on Pax World's Gender Equality Platform visit www.paxworld.com/womensequality. ■

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.

85 Broads and Women's Funding Network are not affiliated with ALPS Distributors, Inc.

Pax World Global Women's Equality Fund

TRADING SYMBOL: PXWEX

MINIMUM INITIAL INVESTMENT: \$250

INVESTMENT OBJECTIVE:

Seeks long-term growth of capital

For more information about the Pax World Global Women's Equality Fund, visit www.paxworld.com/gwef



of other critical issues. These things matter. They matter to the economy, to people, to investors. We are at an inflection point. We can either summon the collective will to invest in our common future or continue to stumble along hoping the next asset bubble temporarily bails us out while entering into a period of long national decline.

So, while policy makers continue to dither and bicker, are there things that we as investors can do to make a difference? At Pax World, we ask ourselves that question all the time, and in 2010 we did our best to answer in the affirmative—and to make a positive contribution.

We sent letters to Congress, the White House, and the Securities and Exchange Commission (SEC) supporting key provisions of the Dodd-Frank financial reforms, such as proxy access allowing investors to nominate board candidates. We used our power as a shareholder to file “Say-on-Pay” resolutions at several companies asking for an advisory vote on executive compensation. We also filed shareholder resolutions asking companies to review their political contributions policies in light of the U.S. Supreme Court’s decision in *Citizens United vs. Federal Election Commission* allowing unlimited use of corporate assets to fund independent political ads.

On the environmental front, Pax World filed resolutions on the ecological impacts of oil sands operations and hydraulic fracturing (or “fracking”) for natural gas extraction, and with fellow institutional investors sent letters to Congress, the Environmental Protection Agency (EPA) and others urging action on climate change legislation, increased fuel economy standards, and improved sustainability reporting.



Pax World President and CEO Joe Keefe (center) rang the opening bell of the New York Stock Exchange (NYSE), on May 24, 2010, to celebrate the listing of ESG Shares® Pax MSCI North America ESG Index ETF (NASI) on the NYSE Arca. Photo courtesy of NYSE.

We also continued our ongoing work on gender equality and women’s empowerment by withholding support from all-male board slates while leading campaigns to encourage companies to embrace gender diversity on their boards and to endorse the Women’s Empowerment Principles, an initiative of the UN Global Compact and UNIFEM.

We also launched two new series of funds for sustainable investors: the ESG Managers™ Portfolios, a series of multi-manager asset allocation funds with asset allocation, manager selection and portfolio construction by Morningstar Associates; and ESG Shares®, the first family of ETFs focused exclusively on a sustainable investing approach.

As 2010 drew to a close, there were some positive signs on the horizon. American corporations now have the strongest balance sheets, the most cash and the lowest cost of capital in decades. There are many who think that 2011 will be a better year

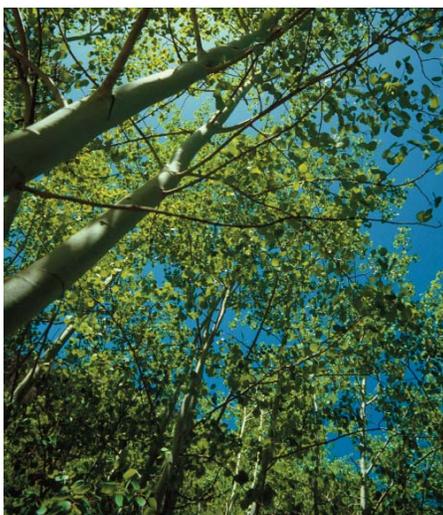
economically than 2010. Count Pax World among the cautious optimists.

Still, the question remains: where will the leadership come from? Let me humbly submit that we, as investors, have to share this burden of leadership. No one’s going to fix the economy for us. It’s ours to fix. And the next economy clearly will need to focus on real, long-term value creation rather than continued short-term profits derived from asset bubbles, financial engineering and hyper trading. We, as investors, must do everything we can to ensure that corporations and markets produce better long-term social and environmental outcomes. That’s what sustainable investing is all about. At Pax World, we tried our best to advance these goals in 2010, and we enter 2011 with renewed commitment and enthusiasm. Thank you for your business. ■

ESG Managers™ Portfolios are available only through registered financial advisors.

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Shareholder Corner



Pax World Improves Sustainable Printing Capabilities

Pax World is shifting from using recycled paper in our quarterly statements and transaction confirmations to paper that is independently certified by the Forest Stewardship Council (FSC). FSC is an independent, non-governmental, not-for-profit organization established to promote the responsible management of the world's forests. In addition, our envelopes are fully recyclable, including the clear plastic window material which is made from renewable plant resources. For more information about FSC visit www.fsc.org.

Help Reduce Paper Waste

If you'd like to reduce the amount of paper mailings you receive from Pax World, sign-up for Pax World

E-Delivery. Visit www.paxworld.com, select the orange LOGIN button at the top right of the page. Once you are logged in, choose E-Delivery from the Account Options menu at the top of the page. Shareholder communications will be sent to you in an e-mail with links directing you to our website where you can view or download documents.

Have you moved? Changed your E-mail address?

It's important to keep Pax World informed of your current address and contact information. If the U.S. Postal Service returns your mail as undeliverable, or there is no activity in your account within the time period specified by applicable state law, your account may be closed and the proceeds transferred to the appropriate state.

Pax World works with The Keane Organization to look for updated addresses for "lost shareholders." If you receive a notice asking you to confirm your new address, please respond to either Pax World or The Keane Organization to update your account.

To verify that Pax World has your most current mailing address, phone number and e-mail address, log on to our online access at www.paxworld.com or call 800-372-7827, Monday – Friday, 8 a.m. - 6 p.m. EST. ■



At Your Fingertips— Important 2010 Tax Information and Dates

Deadline for a 2010 IRA contribution:
April 15, 2011

2010 Traditional and/or Roth IRA Contribution Limits: \$5,000/\$6,000
age 50 or older

Tax form mailing deadline 1099-R & 1099-Q: January 31, 2011

Tax form mailing deadline 1099-B*, 1099-DIV, 1099-INT: February 15, 2011

Tax form mailing deadline 5498:
May 31, 2011

Year-end statements ONLINE:
January 7, 2011

Tax-forms ONLINE (available to download):
March 1, 2011

Qualified Dividend Income and Pass-Through Exemptions Information ONLINE: January 21, 2011

*1099-R reports redemptions from retirement accounts; 1099-Q reports redemptions from a Coverdell ESA; 1099-B reports redemptions from a non-retirement account; 1099-DIV reports taxable dividends and capital gains paid to non-retirement accounts; 1099-INT reports taxable interest income earned on a non-retirement account; 5498 reports retirement account contributions.
Cost Basis information will be included with 1099-B forms, if applicable.

Important Disclosures Please Read

Before investing in a Pax World Mutual Fund, ESG Shares®, and ESG Managers™ Portfolios you should carefully consider the objectives, risks, charges and expenses. For this and other important information, please obtain a Fund prospectus by calling 800.767.1729. Please read the prospectus carefully before investing.

The value of the Fund's investments will vary from day to day in response to the activities of individual companies and general market and economic conditions.

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