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## It is time for low-risk small cap investing

By Nathan Moser, CFA®

Small cap equities, as measured by the Russell 2000 Index,<sup>1</sup> delivered consistently positive returns over the one-, three- and five-year periods ending September 30, 2014. However, small cap stock performance was quite volatile in 2014. What should small cap stock investors take away from the past year?

Despite a volatile 2014, many advisors and investors continue to believe a well-balanced portfolio should include a small cap stock allocation. Small cap equity allocations diversify a portfolio, spreading risk across a broader range of equity capitalizations. Small caps also have the potential to outperform large caps.

So, in short, I believe 2014 showed that a small cap allocation should be invested in a fund with a proven risk-management discipline.

Investors also should understand that small cap underperformance relative to large cap in 2014 was a normal response to high valuations that built-up over time.

U.S. Federal Reserve (Fed) quantitative easing<sup>2</sup> (QE) and low interest rate policies created high liquidity. Liquidity increased investor risk tolerance and drove stock prices higher. When the Fed ended QE, investors reduced risk. Small cap stocks, often perceived as risky, saw price declines.

On the positive side, Fed policies increased cash levels on corporate balance sheets. Some of that cash drove merger and acquisition (M&A) activity higher. M&A can push stock prices up, particularly among companies being acquired—which are often small caps.

The Pax World Small Cap Fund had eight holdings involved in deals this year that were beneficial to performance. M&A volume in the pipeline remains

high. I expect sustained M&A activity in 2015, assuming no extraordinary financial system shocks.

Our approach to managing the Pax World Small Cap Fund hasn't changed since its 2008 launch. We identify quality stock investments, focus on valuation changes compared to our estimates and, if investments approach the upper limits of our ranges, we sell them.

We continue to believe the small cap market is inefficient. With thousands of stocks and a limited number of analysts and managers active in the small cap market, opportunities to create value through astute stock selection present themselves even in declining markets.

Investors taking extra steps in security research may be better positioned to add value over time. Integrating robust fundamental analysis with environmental, social and governance (ESG) analysis adds a level of due diligence other managers do not have.

We focus on protecting gains earned in positive markets from potential losses as markets turn. We take steps each day that we believe will position the Fund to navigate choppy markets with lower volatility. 

**RISK:** 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.

**The Small Cap Fund's investment objective is to seek long-term growth of capital.**

<sup>1</sup> The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. One cannot invest directly in an index.

<sup>2</sup> Quantitative easing is monetary policy used by central banks to stimulate a national economy, typically by buying financial assets from commercial banks and other private institutions.

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# Pax World spotlight: Women Thrive Worldwide

Since its inception in 1998, Women Thrive Worldwide (WTW) ([www.womenthrive.org](http://www.womenthrive.org)) has worked to ensure that women and girls around the world have the ear of decision-makers in Washington, D.C.

WTW works to create a world in which women and men work together as equals so that they, their families and their communities can thrive. It advocates for change at the U.S. and global levels so that women and men can share equally in opportunities, economic prosperity and freedom from fear and violence. It partners with locally-based organizations to create powerful coalitions that can advance the interests of women and girls.

Along with Mercy Corps, Women Thrive Worldwide participates in the Pax World Global Citizen Program ([paxworld.com/globalcitizen](http://paxworld.com/globalcitizen)), which enables Pax World shareholders to earmark portions of their dividends and/or capital gains as a contribution to one of two non-profit organizations.

Among WTW's major accomplishments in the past year, supported by Pax World shareholder funding, was publication of "Less Than Two Dollars a Day: Creating Economic Opportunity for Women and Men Living in Extreme Poverty," which identified the greatest obstacles to economic opportunity for women living on



Women Thrive arranged for Lydia Sasu (right) to represent the voice of thousands of rural women farmers in Ghana at its summit on women's economic opportunity. *Photo credit: Women Thrive Worldwide.*

less than two dollars a day. In addition, WTW convened the summit "Out of Extreme Poverty: Women Leading the Way."

WTW and the Coalition to End Violence Against Women and Girls Globally pushed for the first-ever funding to specifically implement programs to address gender-based violence (GBV) and increase GBV-focused budgeting, reporting, and program implementation. This effort included a \$10 million program to expand medical, psychosocial and legal assistance, and income generation for GBV survivors in the Democratic Republic of Congo.

WTW's "The Path to Inclusive Development" report assessed implementation of USAID's

Gender Equality and Female Empowerment Policy, including recommendations on how to comprehensively address GBV and integrate GBV prevention and response into broader frameworks such as women's economic opportunity or hunger and food security.

WTW and its partners also advanced a global goal that seeks to develop "inclusive and equitable quality education and promote life-long learning opportunities for all," trained 50 grassroots leaders in Kenya and 50 education activists from all over Africa to push for quality learning for all children, and highlighted the importance of girls' education at the African Leaders Summit. 🌱

## Pax World brings attention to Emerge Global

This year Pax World highlighted among financial advisors the work of Emerge Global, a non-profit organization supporting women around the world. Emerge Global is a non-profit that supports teenage girls in Sri Lanka who have survived abuse and are currently living in shelters while they testify in court against their perpetrators. Over the past two years, the program has enabled more than 80 girls to express themselves creatively while generating money for their futures. Pax World purchased and donated Emerge Global products at a major conference during the fall of 2014.

Based in San Francisco, Emerge Global has established projects that produce handmade, one-of-a-kind jewelry including beaded jewelry, handmade jewelry, glass beads, bracelets



*Photo credit: Gretchen Eastman*

and necklaces.

Emerge partners with the shelters serving these women to transform them into entrepreneurship hubs where girls develop the business and life skills needed for self-sufficiency. The Emerge Beads-to-Business Program teaches girls to set up and run their own small businesses while simultaneously generating the savings needed to do so. Emerge also supports participants through a comprehensive Life Skills Program, teaching financial management, reproductive health, job readiness skills and more, as well as a Mentorship Program with local women.

You can learn more about Emerge Global and its online store at [www.emergeglobal.org](http://www.emergeglobal.org). 🌱

# High impact investments drive measurable improvements on sustainability and community projects globally

Pax World is an active participant in the quickly expanding market for green bond and related investments that are funding important environmental, infrastructure and community development efforts globally. These high impact investments include:

- Green bonds and financing for sustainable infrastructure projects, and
- Community investment notes and certificates of deposit (CDs).

As of October 31, 2014, Pax World held approximately \$33 million in such high impact investments.

## Green bonds and sustainable infrastructure

Pax World invests in green bonds issued by the World Bank, Bank of America, and State of California and sustainable infrastructure projects in several states. These investments may fund projects including energy efficiency, renewable energy finance, consumer financing for sustainable technologies, climate change mitigation, and natural resource conservation, among others. Projects Pax World is financing with its investments include:

- International Finance Corporation (IFC), a member of the World Bank Group, is the largest global development institution focused on the private sector in developing countries. IFC mobilizes capital from others and advises businesses with the goal of employing more people and delivering essential services to ensure sustainable development in the areas of energy efficiency and renewable energy.
- Bank of America Green Bonds fund projects including financing of investments in equipment and systems that facilitate the use of energy from renewable sources such as solar, wind, and geothermal energy to reduce energy consumption. Projects include lighting retrofits, district heating, co-generation, and building insulation in residential, commercial and public properties.
- State of California Green Bonds finance environmentally beneficial projects

## Impact Investing in Fixed Income at Pax World

Pax World works to achieve measurable impacts on sustainability through its fixed income investments primarily through the following:



Source: Pax World Management LLC as of 10/31/2014. Subject to change.

addressing air pollution reduction, clean water and drinking water, energy efficiency and conservation projects in public buildings, protection of beaches, bays and coastal waterways, flood prevention and sustainable communities and climate change reduction.

- City of Portland, Oregon Urban Renewal Bonds re-fund maturing bonds issued beginning in 1985 to fund redevelopment and urban renewal projects in Portland. The projects have environmental benefits including improving the downtown transit system, providing new and remediating open spaces in the city, and supporting a mix of low, middle income, and business in downtown neighborhoods.
- Alderwood Water and Wastewater District Bonds fund capital improvements to the district's water and sewer facilities. Formed in 1931, Alderwood is the largest water and sewer district in the state of Washington, providing water and sanitary sewer service to more than 250,000 retail and wholesale customers.
- North American Development Bank and its sister institution, the Border Environment Cooperation Commission finance projects that address environmental and human health problems near the U.S.-Mexico border.

## Community investment notes and CDs

Pax World invests in communities and promotes sustainable development, most commonly through ongoing investments in short-term debt instruments issued by non-corporate entities and CDs issued by community banking entities. Current investments include the Calvert Foundation, CEI Investment Notes, the Enterprise Community Loan Foundation, Hope Credit Union, One PacificCoast Bank (now Beneficial State Bank), Self-Help Credit Union and Urban Partnership Bank.

Pax World seeks to invest with organizations that target underserved localities in the areas of affordable housing, small businesses, community development and revitalization, health care, education, women's equality, and the environment, among others.

"Pax World believes these investments will positively impact underserved localities, an important principle of its investment and business philosophy," explains Pax World Chief Investment Officer Steve Falci. "From an investment perspective, these bonds and related debt securities generally are of high quality. They are issued by financially sound organizations and have predictable and stable revenue streams which can fund interest and principal payments to bondholders. Through these investments, we are putting our shareholders' assets to work to help improve the quality of life of people in communities around the world." 

# Shareholder Corner: Timely reminders for Pax World investors

## As the New Year approaches, it is a good opportunity for tax and retirement planning.

2014 contributions to Individual Retirement Accounts (IRAs) usually can be made until April 15, 2015.

Many factors can affect your eligibility and contribution limits to either the Traditional IRA or Roth IRA. They include factors such as tax filing status, current earned income and whether or not you participate in a retirement plan at work. If you are under 50 years of age for 2014 and 2015, typically you can contribute the lesser of 100% of earned income or \$5,500. If you are 50 years of age or older before the end of 2014, you can contribute the lesser of 100% of earned income or \$6,500 for 2014 and 2015.

Contributions may be split between a Traditional IRA and a Roth IRA.

Traditional IRA contributions are typically made on a tax-deferred basis. That means, you may be able to deduct some or all of your

## Important 2014 documents mailed and/or available online:

**January 31, 2015:** IRS forms combined 1099-DIV/B, 1099-R, 1099-INT, and 1099-Q

**January 31, 2015 (online only):** Qualified Dividend Income and Pass-Through Exemptions Information

**April 30, 2015:** IRS form 5498 ESA

**May 31, 2015:** IRS form 5498

1099-DIV reports taxable dividends and capital gains paid to non-retirement accounts; 1099-B reports redemptions from a non-retirement account and cost basis for covered shares; 1099-R reports redemptions from retirement accounts; 1099-INT reports taxable interest income earned on a non-retirement account; and 1099-Q reports redemptions from a Coverdell ESA; 5498-ESA reports Coverdell Education Savings Account contributions; and 5498 reports retirement account contributions.

contribution from your income for income tax purposes depending on some of the factors listed above. Taxes are typically paid when funds are withdrawn, presumably in retirement, when you may be in a lower tax bracket.

Contributions to Roth IRAs are not tax-deductible because they are funded with money on which income taxes already have

been paid. After five years, certain types of withdrawals, including those taken in retirement, can be made on a tax-free basis.

*Please note that the information above does not constitute tax advice. State tax regulations may differ from federal tax regulations. Always consult your tax advisor before making any tax-related investment decision.* 

## Stay in touch

It is important that you contact your mutual fund company regularly. Many states have inactivity, or the absence of customer-initiated contact, as a component of their rules for the escheatment of unclaimed property. Contact must be initiated by the investor, rather than by the mutual fund company. If we don't hear from you, we may be required to transfer your mutual fund assets to your state's unclaimed property division. Retirement accounts such as IRAs have longer holding periods and generally are not required to be turned over to your

state until you reach the age of 70½.

Examples of contact are logging on to our online account access, calling our toll-free phone number, account maintenance or a transaction that is not an automatic purchase or withdrawal arrangement, or voting a proxy. VT, NY, OK and TN require written or online contact, not a phone call.

## We're here for you

You can find help by calling Pax World Investor Services at 800.372.7827, Monday – Friday, 8 a.m. – 6 p.m. ET. You can handle the following transactions online by using

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- view or download statements or tax forms.
- open an IRA or make an IRA contribution using a bank account currently attached to your mutual fund account. 



Pax World Investments

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**You should consider a fund's investment objectives, risks, and charges and expenses carefully before investing. For this and other important information, please obtain a fund prospectus by calling 800.767.1729 or visiting [www.paxworld.com](http://www.paxworld.com). Please read it carefully before investing.**

**An investment in the Pax World Funds involves risk, including loss of principal. Past performance is no guarantee of future results.**

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