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Chris Brown, Pax World
Chief Investment Officer
and Portfolio Manager

Pax World Market Update

Many are anxious, but opportunities exist for investors with long-term view

Recent stock market volatility has many U.S. investors concerned about their portfolios. In fact, on August 8, 2011, the Dow Jones Industrial Average¹ dropped over 600 points following Standard and Poor's downgrade of U.S. Treasuries. The market partially rebounded by that week's end, but the roller coaster has continued.

Connection talked with Pax World Chief Investment Officer and Balanced Fund Portfolio Manager Chris Brown about the factors driving today's unsettling market movements and potential opportunities for investors who "stay the course."

What are the factors behind the recent extreme market volatility? The controversial passage of the U.S. debt ceiling increase and subsequent downgrade of U.S. Treasuries has certainly added to recent investor anxiety. However, the main driver has been investors' fear that we are headed for a "double-dip" recession. And with good reason: tepid gross domestic product (GDP) growth, high unemployment and slowing manufacturing activity—to name a few—have given investors reason for concern. The U.S. is not alone in this volatility. European sovereign debt issues continue to plague the global markets as well.

The markets are reminding many investors of the 2008 crisis. Are there similarities here? The 2008 financial crisis appears to be the benchmark for investor fear. By and large, the greatest similarity to 2008 has been the

recent volatility and negative investor sentiment. However, we believe there is great dissimilarity to the 2008 crisis. Compared to 2008, corporations are now generally in much better financial shape with significant amounts of cash on their balance sheets. As a result, we have seen a proliferation of companies buying back their own stock; this implies that management may believe there is good value in owning its company shares. Default rates remain low as companies have already refinanced their high interest rate debt with lower interest rate paper. At the moment, we are also not facing the credit freeze that we experienced in 2008 as liquidity remains adequate due to low interest rates and government stimulus.

Are we headed into a "Double Dip" recessionary environment? The markets appear to be pricing in a recession. We are in uncharted waters with respect to the economy and the global challenges we face, which makes for a difficult forecast. While we acknowledge the significant obstacles the economy faces, and while we believe GDP will continue to decelerate in the short-term,

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Recent Market Volatility Creates Potential Investment Opportunity in High-Yield Bonds

by Mary Austin, CFA, Pax World High Yield Bond Fund Portfolio Manager

It came as little surprise to us that investors around the world recently fled from equities into the safety of U.S. Government bonds over concerns about investment risk and the global economic recovery.

Continued tepid growth, European sovereign debt problems, and the lack of confidence in our own government to resolve fiscal issues—which ultimately led to the downgrade of its rating by Standard & Poor’s—are just some of the catalysts for recent market volatility.

In this environment, many financial experts, including Pax World’s portfolio managers, believe large-cap stocks that pay dividends may offer investors a potential safe haven. We also believe that investing in high-yield bonds is a particularly attractive option for investors on a risk-adjusted return basis. In our view, high-yield bonds have come off their recent highs, mostly due to risk aversion—not fundamentals, which we believe remain intact. As we have noted in the last few quarterly High Yield Bond Fund reports, many companies have much stronger balance sheets than they did several years ago, before they were able to refinance their debt at lower interest rates.

Driven by the flight to U.S. Treasuries, the BofA Merrill Lynch U.S. High Yield BB-B (Constrained 2%) Index¹ yield was 8% on Aug 31, 2011. We consider this yield to be very attractive, especially in view of the fact that high-yield bonds have historically been less volatile than stocks and typically are less correlated to the equity markets.

Additionally, high-yield bonds have historically performed well in a low interest rate environment. With the Federal Reserve’s pledge in early August to keep interest rates low for at least two more years anticipating a slow economic recovery, high-yield bonds may be a more attractive option on a risk-adjusted basis when compared to equities or other fixed income classes. We do expect volatility will continue,

but less so for those high-yield bond funds that are positioned more defensively, such as the Pax World High Yield Bond Fund.

* * * * *

Under the direction of Mary Austin, CFA, who has been with the Fund since 1999, the Pax World High Yield Bond Fund seeks primarily current income,

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High-yield bonds have a history of outperformance vs. the S&P 500 Index².

Over the past 10 years, high-yield bonds, as represented by the BofA Merrill Lynch U.S. High Yield BB-B (Constrained 2%) Index have outperformed the S&P 500 Index.

Cumulative Returns



Past Performance is not a guarantee of future results. Investors cannot invest directly in an index.

Meeting Challenges with Sustainable Solutions in the Horn of Africa

Photos and stories from the hunger crisis in the Horn of Africa—a region that includes Ethiopia, Kenya and Somalia—have brought to light suffering on an almost unimaginable scale. The needs are great, with more than 12 million people at risk of starvation in the midst of the worst drought the region has seen in sixty years.

This disaster did not happen overnight. For years, the Horn of Africa has been getting progressively drier. The past two seasonal rains have failed, and some areas haven't seen rain in three years. Pax World's long-time partner Mercy Corps is on the ground in Ethiopia, Kenya and Somalia. They're not only meeting families' immediate needs, but are also investing in long-term solutions that will help communities withstand future crises. Their program areas include:

- **Health:** Diagnosing and treating malnutrition in mothers and children using mobile health clinics.
- **Commerce:** Starting a voucher program that allows poor people to purchase the goods they need—and bolster local commerce.



Mohammad is part of a cooperative of farmers that Mercy Corps brought together and helped buy tools and seeds. Since then they've seen their incomes rise and are feeding their families despite the drought. "Everything is possible," says Mohammad. Photo: Erin Gray/Mercy Corps



Three-year-old Hibo is tiny for her age because she suffered from severe acute malnutrition. Thanks to Mercy Corps' mobile health clinic, she got the food and care she needed to get back to being an ordinary, mischievous toddler. Photo: Erin Gray/Mercy Corps

- **Water:** Trucking in hundreds of thousands of liters of clean water, plus water storage tanks and fuel for generators that draw water from wells.
- **Credit:** Providing credit so traders can buy frail cattle, goats and sheep from herders who would lose everything if the animals died. Herders get a fair price for their animals—money that helps their families survive.

In the midst of the crisis Mercy Corps received contributions from hundreds of shareholders through the Pax World Global Citizen Program. Their investments are producing social returns now and in the future: just \$6 provides four servings of nutrient-rich food to help a malnourished child survive, while \$32 trains four farmers in improved agricultural techniques which will help feed their families in the years ahead.

Pax World is proud to partner with Mercy Corps in their work to help communities around the globe survive current crises—and build back stronger. For more information visit www.paxworld.com/about-pax-world/global-citizen.

Pax World Shareholders & Mercy Corps:

Working Together to End Global Poverty

Pax World's Global Citizen Program is a unique way for shareholders to support innovative and sustainable solutions to global poverty by designating dividends or capital gains earnings from their investment accounts to Mercy Corps' work around the world.

- Working together to find sustainable solutions to poverty since 1986
- First project: Health clinic in remote village in Honduras
- Amount shareholders have contributed via their accounts: \$1.2 million
- Shareholders who have participated in Global Citizen Program: 1,356
- Key Mercy Corps initiatives: Sustainable economic development, emergency relief, women's empowerment
- Mercy Corps' Charity Navigator Rating: 4 Stars

Pax World's Global Citizen Program enables Pax World Shareholders to earmark portions of their dividends and/or capital gains as a contribution to one of two non-profit organizations that are working to alleviate poverty, empower women and promote sustainable development around the globe, Mercy Corps and Women Thrive Worldwide.

Contributions to the Global Citizen Program are tax-deductible. Learn more at www.paxworld.com/about-pax-world/global-citizen

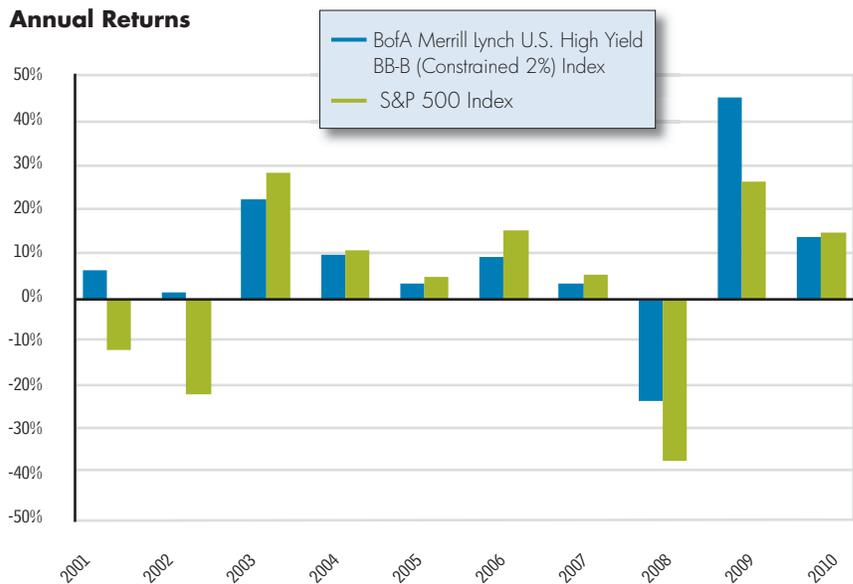
and secondarily capital appreciation, by investing in high-yield securities of companies the portfolio manager identifies as having strong fundamentals and improving financial results. Further, through the use of fundamental analysis and her own proprietary models, Ms. Austin seeks to identify high-quality companies with the potential to grow revenues, improve margins and decrease leverage. It is the only high-yield bond fund that follows a Sustainable Investing approach through the full integration of Environmental, Social and Governance (ESG) factors in investment analysis and decision making. The Fund invests primarily in high-yield, fixed-income securities rated below BBB-³ by Standard & Poor's Ratings Group or below Baa3⁴ by Moody's Investors Service, or unrated securities of comparable quality.

To learn more about the Pax World High Yield Bond Fund, visit paxworld.com/highyieldbond.

Investments in high yield bonds generally are subjected to greater price volatility based on fluctuations in issuer and credit quality. Yield and share price will vary with changes in interest rates and market conditions. Investors should note that if interest rates rise significantly from current levels, bond fund total returns will decline and may even turn negative in the short term. There is also a chance that some of the fund's holdings may have their credit rating downgraded or may default. Foreign investing involves risks such as currency fluctuations and political uncertainty.

High-yield bonds outperform equities in down markets

Over the past 10 annual periods, high-yield bonds, as represented by the BofA Merrill Lynch U.S. High Yield BB-B (Constrained 2%) Index, have outperformed equities, as represented by the S&P 500 Index, during severe markets downturns.



Past Performance is not a guarantee of future results. Investors cannot invest directly in an index.

¹The BofA Merrill Lynch U.S. High Yield BB-B (Constrained 2%) Index tracks the performance of BB- and B-rated fixed income securities publicly issued in the major domestic or eurobond markets, with total index allocation to an individual issuer limited to 2%. Investors cannot invest directly in an index.

²The S&P 500 Index is the Standard & Poor's composite index of 500 large capitalization stocks, a widely recognized, unmanaged index of common stock prices. Investors cannot invest directly in an index.

³BBB- rating is Standard & Poor's rating of bonds of

adequate credit quality. Protection of interest and principal is considered adequate, but the entity is more susceptible to adverse changes in financial and economic conditions, or there may be other adversities present which reduce the strength of the entity and its rated securities.

⁴Baa3 rating is a Moody's rating of bonds. Obligations rated Baa are subject to moderate credit risk. They are considered medium-grade and as such may possess certain speculative characteristics.

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Pax World High Yield Bond Fund

TRADING SYMBOL: PAXHX

MINIMUM INITIAL INVESTMENT: \$250

INVESTMENT OBJECTIVE: High current income; as a secondary objective, the Fund seeks capital appreciation.

For more information on the Pax World High Yield Bond Fund please visit www.paxworld.com/highyieldbond.

we do not believe it will be to the extent of providing negative growth.

“It’s important for all investors to maintain a long-term outlook during periods of extreme market movements.”

Given the issues you discussed above, what is your market outlook and what sectors look particularly promising? In the near term, we believe the market will most likely continue to exhibit volatility as economic numbers are likely to be a “mixed bag” with respect to the economic recovery. Against this backdrop, we believe high-quality companies with attractive dividend yields are sound investment choices right now. We view the industrial sector as very attractive with respect to dividend yields, as well as companies exposed to the growing need for food and water around the world. The high-yield market also looks promising due to the projected low default rates and bond yields.

How is the Pax World investment team responding to the current market challenges/opportunities? At Pax we view market volatility as an opportunity to invest in attractive companies, those that we believe should prosper regardless of the current economic environment. Risk management is, of course, a key element of our investment process. We strive to offer our shareholders competitive risk-adjusted returns.

It’s important for all investors to

maintain a long-term outlook during periods of extreme market movements. History has shown that investors typically put money into the market at or near the top and tend to sell out during periods of extreme decline and volatility². Historically, this has not been a wise strategy. Over the long-term, the U.S. stock market as represented by the S&P 500 Index³ has delivered 8.73%⁴ in average annual returns over the last 20 years.

Investors who stay the course, and focus on maintaining an investment

portfolio that aligns with their financial goals, time horizon and risk tolerance, are in our view, best positioned to ride out difficult market environments like today’s. ■

¹The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq.

²Malkiel, Burton. “Don’t Panic About the Stock Market.” *The Wall Street Journal*, August 8, 2011.

³The S&P 500 Index is the Standard & Poor’s composite index of 500 large capitalization stocks, a widely recognized, unmanaged index of common stock prices. Investors cannot invest directly in an index.

⁴Source: Factset. Based on returns of the S&P 500 Index for the period 6/30/1991 through 6/30/2011.

“Stay the course” strategy may pay off over the long term

It’s wise to maintain a long-term outlook during periods of extreme market movements. History has shown that many investors put money into the market at or near the top and tend to sell out during periods of extreme decline and volatility². Over the past 20-year period, the U.S. stock market as represented by the S&P 500 Index³ has delivered 8.73%⁴ in average annualized or 433.64% in cumulative returns for investors who “stayed the course.”



Source: Factset
Past Performance is not a guarantee of future results.
Investors cannot invest directly in an index.

Proxy Voting Season Wrap Up

Pax World's 2011 shareholder and public policy advocacy has focused on environmental and governance-related initiatives. Pax participated in several shareholder initiatives to improve public policies or company protocols and disclosures with respect to gender and human rights, financial reform, and workplace practices and also co-filed five shareholder resolutions, two of which were successfully withdrawn.



A few highlights:

Environmental Initiatives

Shareholders and investment managers continued to press both government policymakers and companies to improve regulations and practices to protect the environment. During the 2011 proxy season, Pax World signed on to 18 environmental initiatives, many of which focused on the oil and gas industry. Pax World, for example, joined with other investors in the Investor Network on Climate Risk urging California voters to oppose Proposition 23, a statewide ballot initiative that would have stopped implementation of the state's landmark clean energy bill. The proposition was rejected in the fall 2010 election.

Governance-related Initiatives

Pax World continued its advocacy in favor of improved corporate governance practices in 2011,

participating with other investors on initiatives regarding executive compensation, disclosure of expenditures on lobbying and political contributions, reducing dissonance between corporate policies and trade association lobbying, and bolstering shareholder rights. Pax World joined efforts led by Walden Asset Management and the Center for Political Accountability to write to companies addressing misalignments between company policies on the environment and climate change and the policies and lobbying of two trade associations—the US Chamber of Commerce and the National Association of Manufacturers (NAM)—of which they are members.

Gender and Human Rights

Pax World continued to lead an investor initiative in collaboration with the United Nations Principles for

Responsible Investment (UNPRI), Calvert, and other institutional investors to encourage greater gender equality on boards of directors and in senior management, and to promote improved disclosure. This year, Pax World launched a campaign to promote greater gender diversity on corporate boards by encouraging investors to vote no on proxies that did not contain a sufficient number of women. During the proxy season, Pax World withheld votes from, or voted against, 264 director slates for insufficient gender diversity, sending notification letters to those companies explaining why and offering guidelines to improve diversity.

Financial Reform

Pax World sent several letters to members of Congress and the White House in the final weeks of deliberation over the Dodd-Frank Wall Street Reform and Consumer Protection Act, urging that it mandate director election reform by requiring that shareholder nominees, under appropriate conditions, be included in company proxy materials and that it also mandate majority voting for directors.

For complete details on Pax World's 2011 shareholder and public policy advocacy initiatives, visit <http://www.paxworld.com/news-resources/pax-world-news/detail/55>. ■

Important Disclosures Please Read

Before investing in a Pax World Mutual Fund you should carefully consider the fund's 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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