Connection

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INSIDE

Despite Challenging Times, Companies Maintain Sustainability Focus

BY JULIE GORTE, PH.D., PAX WORLD SENIOR VICE PRESIDENT FOR SUSTAINABLE INVESTING

Economic downturns are painful and wrenching. But all crises are enormously effective at distinguishing the essential in our lives from the optional. Recessions are times to bid goodbye to the extras, to eliminate all but what is necessary. Past recessions have compromised many promising corporate environmental or social initiatives. There are now undoubtedly pundits looking to write the predictable obituaries of various corporate sustainability initiatives, but signs indicate this time around may be different.

Memo to all those who think that corporate social responsibility (CSR) is a synonym for feel-good philanthropy: Wake up! CSR these days is mainly about reducing environmental impact, going carbon-neutral and assuring that workers are motivated and productive. It is about protecting the brand, which means not just being very good, but also includes awareness that years of reputation-building can be undone by one big mistake. These are not optional programs; they're not about supporting the ballet and sponsoring youth soccer. They are part of the core mission of many of today's corporations.

It is clear from the frequent corporate dialogues in which Pax World takes part that while the current reports of economic pain are very real, CSR is no longer viewed as a low priority or ancillary to a successful core business strategy. For example, Pax World recently participated in multi-stakeholder teams, convened by Ceres—a national network of investors, environmental organizations and other public interest groups working with companies and investors to address sustainability challenges such as global climate change—working with both Dell[1] and AEP[1] (American Electric Power) on sustainability performance and reporting. While both companies have made adjustments due to the difficult economic situation, neither has reduced its commitment

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Pax World Funds Navigate Turbulent Markets

BY CHRIS BROWN, PAX WORLD CHIEF INVESTMENT OFFICER

Market declines and the uncertain economic environment are at the forefront of most investors' minds today. While many individuals have encountered periods of market declines during their lifetimes, losses this time around have been much broader—and swifter—than most have ever experienced. We are in the midst of a financial crisis, not just on a domestic scale, but on a global one, as well. The housing slump and related sub-prime issues that began in early 2008

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The Case for International Investing

AN INTERVIEW WITH PAX WORLD INTERNATIONAL FUND PORTFOLIO MANAGER IVKA KALUS-BYSTRICKY

Attractive investment returns have resulted in increased interest in international opportunities by U.S.-based investors over the past 10 years. However, when markets all over the world decline, as is currently the case, U.S. investors have a tendency to return home. But is this the right strategy?

Connection recently talked with Ivka Kalus-Bystricky, Portfolio Manager of the Pax World International Fund, for insight on why international investing still has a place in a solid long-term investment strategy.

With markets worldwide suffering, are international investments still attractive?

The short answer, I believe, is a resounding "Yes!" While the global equity markets are indeed broadly correlated, I believe there are sound opportunities at the sector, region and currency level. And stocks in any regional market will vary based on both domestic and international factors, so that performance will not be perfectly correlated across countries.

International markets provide the U.S.-based investor with a broader and differentiated investment opportunity set. Well over 50 percent of the world's stocks are traded outside of the United States. International markets provide exposure to pockets of global growth and diverse investment themes that have limited presence in the U.S. markets. For example, most of the world's pure-play wind energy and solar energy stocks are based outside of the United States.

Why did international markets underperform the broader U.S. markets last year?

International markets, as represented by the MSCI EAFE Index (EAFE), are relatively well-balanced among sectors, with one obvious exception—the financial sector—which comprises about 20 percent of the EAFE Index. The almost double weighting of financials in the Index compared to the United States explains virtually all of the underperformance of international versus U.S. stocks in 2008, when the sector suffered dramatic declines globally.

What role does region play in identifying attractive international investment opportunities?

Varying regulatory environments, tax and accounting codes, investor expectations and economic cycles have the potential to impact performance of stocks listed in markets around the world. The best way to illustrate this may be to look at how the regional composition of the markets has changed over time. Twenty years ago, Japan was by far the largest regional market in EAFE, at almost 60 percent. In 1988, the Japanese market was the largest in the world, at about 40 percent of the global market versus 35 percent for the Untied States. But the Japanese market suffered dramatic declines during the 1990's even as the U.S. and European markets soared. By the year 2000, Japan had dwindled to just 24 percent of EAFE and only 10 percent of global markets. During this period of decline, international managers generally underweighted Japan in their portfolios, and most beat their benchmarks with this single allocation decision. A sound understanding of regional differences, along with the ability to project how they impact local stocks, provide the international investor with an opportunity to allocate more funds to regions that have greater potential to outperform.

What about currency opportunities?

Currency can also have a dramatic impact on returns based on regional allocation decisions, since local currency returns are translated back into dollars for the U.S.-based investor. For example, in 2008, European and UK returns were punished by a weak euro and sterling exchange rate, but Japanese returns benefited from a sharply appreciating yen. Thus, regional and currency allocation decisions can provide significant returns for international investors, two sources of outperformance that are not available to investors who focus on investing only in the United States.

Why would investors look overseas while waiting for a market turn-around?

Common wisdom says that the United States typically leads global markets. It is true that the current synchronized global recession started in the United States and was transferred abroad via the global capital markets, or lack thereof, in the current global credit freeze-up. However, once credit markets begin to function again, it does not necessarily follow that "first-in-first-out" scenario will apply in the case

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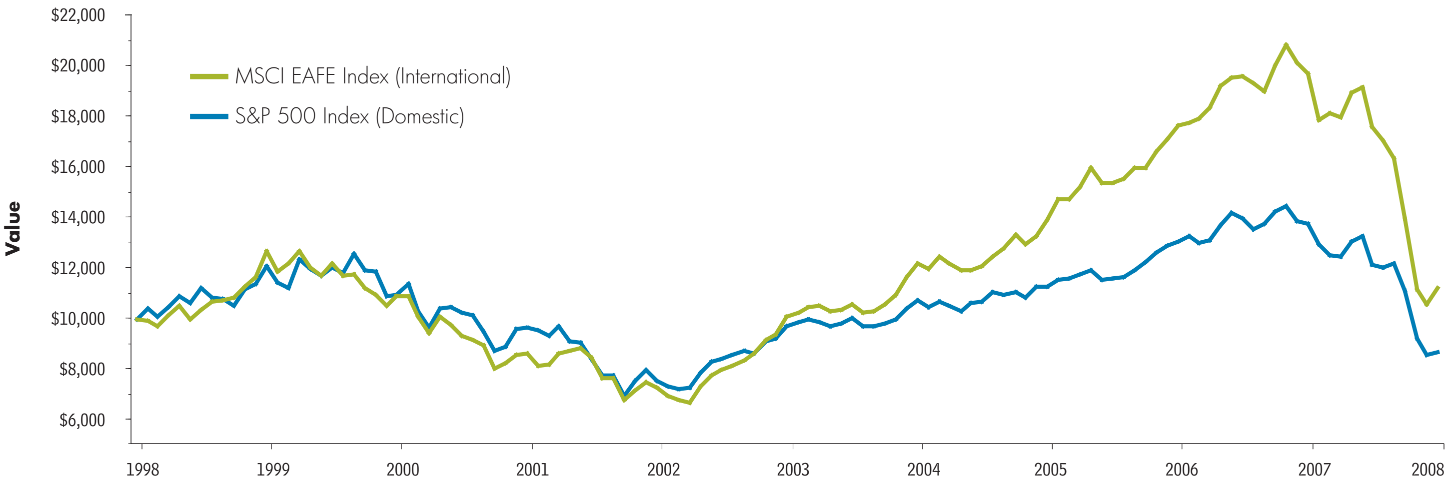
Hypothetical growth of $10,000 invested Internationally vs. Domestically over the past 10 years

As represented by the MSCI EAFE Index vs. the S&P 500 Index as of 12/31/08. Direct invetment cannot be made in an index.



The S&P 500 Index is an unmanaged index of large capitalization common stocks. The MSCI EAFE (Europe, Australasia, Far East) Index is an unmanaged index and is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. & Canada. As of June 2007 the MSCI EAFE Index consisted of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom. ***Past Performance is not a guarantee of future results.***

of economic and market recovery. U.S. public and private sectors face daunting balance sheet repair. In 2009, U.S. government debt will stand at almost 80 percent of Gross Domestic Product (GDP), compared to a global average of around 40 percent. However, the private sector, which comprises the bulk of the U.S. economy, is even more overleveraged, with a credit/GDP ratio of over 200 percent, compared to the global average of 100 percent and by far the highest in the world with the exception of Iceland. Investors may assume that even a significant deleveraging process in the U.S will be offset by the flexibility and innovation that are also hallmarks of the U.S. economy. But many other economies have emulated U.S. virtues without taking on unsustainable debt burdens. So a domestic market bias in the face of tough global market conditions has the potential to deprive investors of the opportunity to take advantage of more favorable regional factors that could potentially deliver superior returns. ■

COMPANIES MAINTAIN SUSTAINABILITY FOCUS CONTINUED FROM FRONT PAGE

to sustainability initiatives. AEP—one of the most significant emitters of greenhouse gases in the western hemisphere—continues to work on carbon capture and storage and to seek opportunities to invest in renewable electricity generation. Dell is maintaining its commitment to reducing its footprints, both direct and across its value chain, from the environmental and human-rights performance of its vendors to programs to recover and recycle computers when they can no longer be used.

In a late 2008 survey, *GreenBiz* asked whether economic conditions had affected green strategies. The survey found that "nearly 47 percent of companies surveyed said they were increasing their investments in green product development in 2009; less than 6 percent said they'd be investing less this year than in 2008."[2] Pepsico's[3] Quaker Oats recently launched a new marketing campaign that emphasizes the benefits to health of whole-grain oats, which is seen as a less expensive source of protein well-suited to weather the economic downturn. Moreover, Pepsico remains a willing participant in another dialogue in which Pax is participating, the Natural Value Initiative that focuses on biodiversity in the food and beverage sector, sponsored by the United Nations Environment Programme Finance Initiative.

There are numerous similar examples of corporations' commitment to sustainability, despite the economic distress. Sustainability is not a frill, if it ever was. The external pressures for sustainability—a warming globe and the spread of regulatory systems limiting greenhouse gas emissions, falling birthrates in many developed nations, increasing scarcity of clean fresh water, and an increasingly wired globe that makes abuse ever-harder to hide—are undiminished. In short, green is what it always was: the color of life, as well as the color of money. That is not an oxymoron. It's a deep truth. ■

[1]As of 2/28/09, Dell and AEP were not held by any Pax World Fund. Holdings are subject to change.

[2]Source: "State of Green Business 2009," Joel Makower and GreenBiz.com, February 2009.

[3]As of 2/28/09, Pepsico was 2.9% of Pax World Balanced Fund, 2.1% of Pax World Growth Fund, and 2.2% of Pax World Women's Equity Fund. Holdings are subject to change.

quickly gained momentum resulting in a global market sell-off not witnessed before by most investors. As markets all over the world declined significantly, a globally-synchronized fiscal and monetary stimulus policy was designed to help stem a severe slowdown of the world economy. It is still too early to judge its effect and only time will tell the ultimate impact. As I predicted late in 2008, negative growth trends have continued into the first part of this year. While we may begin to see some positive traction with respect to the market in the latter part of this year, it is my belief that GDP and S&P 500 Index operating earnings probably won't rebound until early 2010. It will most likely be a slow recovery.

While it's natural to feel some level of market-related anxiety, especially if you're the type of person who keeps a steady eye on your accounts, experienced investors generally realize that the best strategy for these changing

We believe we have positioned each of our Funds to help weather the continued volatility.

times is to maintain a long-term perspective and keep your investments in line with your financial goals.

At Pax World, we manage our portfolios with the same long-term perspective. We entered 2009 feeling well-positioned to manage the impact of this economic situation and ongoing market volatility. We believe stocks and corporate bonds have discounted much of the downturn and offer attractive valuations and yields. For instance, stock and corporate bond yields are now at historic highs versus Treasury bonds as investors' aversion to risk, combined with the Federal Reserve Bank's rate reductions, have driven Treasury yields to historic lows. We see some compelling opportunities in both stocks and corporate bonds, domestic as well as foreign, small-cap companies as well as large. While evaluating the market environment, we continue to keep a vigilant eye towards the massive liquidity that has been injected into the United States and world economies and its potential inflationary impact. We believe we have positioned each of our Funds to help weather the continued volatility and to benefit from what we hope will be a more constructive market in the second half of this year.■

Pax World Balanced Fund Adjusts to Changing Markets BY CHRIS BROWN

In light of the uncertain economic environment, we have re-positioned the Pax World Balanced Fund to take advantage of what we believe to be potential opportunities with an overall defensive posturing. As of 2/28/09, we have an allocation of approximately 62% stocks (down from an average of 70% throughout 2008), 37% fixed income and 1% cash. We are targeting higher-yielding stocks in defensive sectors that we believe can raise dividends even in this market environment. To that end, we have increased the weighting in health care and consumer staples companies. We reduced our equity weighting in industrials and materials as we expect a delayed rebound in those highly cyclical sectors. Realizing that the proposed significant fiscal and monetary stimulus could set the stage for an inflationary environment, we have been slowly increasing our holdings in gold and silver ETFs and Treasury Inflation Protected Notes (TIPS) as well.

On the fixed-income side of the portfolio, we increased our U.S. Treasury holdings in the latter half of 2008, while reducing our agency bonds, two moves which have already benefited the Fund. We are now taking advantage of what we believe to be tremendous opportunity in the investment grade corporate bond market. We have focused on select financial and industrial bonds. We believe the debt securities of certain financial companies should offer a safer margin for error, but with equity-like returns. We favor this strategy of debt over equities due to the government intervention in the operation of these companies which could negatively impact their stocks. While equity holders in these companies could potentially suffer further, bond holders should be better-positioned to benefit as the government-backed capital infusions begin to stabilize the balance sheets of these companies. To a lesser extent we are interested in taxable municipals due to their historically high spreads over Treasuries. As is our general policy, we are primarily focused on investment grade bonds.

We keep our focus on the long-term investment goals of the Fund and our Sustainable Investing approach to manage through changing markets and to maximize investment opportunities when the economy begins its eventual turnaround. ■

Gender Equality Gains Momentum as an Investment Concept

Pax World co-sponsors NYC event with prominent women's issues leaders

On January 22, 2009, Pax World and Demos, a national, non-partisan public policy center, along with several other women's interest organizations, hosted an engaging and timely panel discussion on "Gender Equality as an Investment Concept." The event, which was part of Demos' ongoing Women's Leadership Initiative, was held at the organization's New York City headquarters, and featured prominent leaders and experts on women's issues including Pax World President and CEO Joe Keefe.

"Economists and historians will tell you that the best clue to a nation's growth and development potential is the status and role of women," said Mr. Keefe, during his remarks. "If that is true, then it quite logically and obviously follows that investing in improving the status and expanding the role of women—investing in women's empowerment—should be a central strategy for economic growth. Corporations, and markets themselves, need to become vehicles for advancing gender equality and the global empowerment of women."

A growing body of research has found that the inclusion of the analysis of companies' attitudes toward women's empowerment and advancement has the potential to offer specific long-term investment performance advantages. Consider the following:

- A recent study found that companies across a wide range of industries with the highest representation of women outperformed those with the least in the important areas of return on equity, return on sales and return on invested capital.[1]
- The 25 Fortune 500 firms with the best record of promoting women to high positions were between 18 and 69 percent more profitable than the median Fortune 500 firms in their respective industries. These top 25 companies for women in the Fortune 500 exhibited consistently higher profitability.[2]
- A cross-sectional study of boards of directors of 1024 publicly traded firms in found that:
  1. Firms facing more variability in their stock returns have fewer women on their boards of directors;
  2. Firms with more diverse boards provide their directors with more pay performance incentives; and
  3. Firms with more diverse boards hold more board meetings. Female directors have fewer attendance problems at board meetings.[3]

"Economists and historians will tell you that the best clue to a nation's growth and development potential is the status and role of women."

JOE KEEFE, PAX WORLD PRESIDENT & CEO

Other participants in the Demos panel were Ritu Sharma, Co-Founder and CEO of Women Thrive Worldwide and a leading voice on international women's issues and U.S. foreign policy, and Anne Black, a Vice President and member of the Corporate Engagement team at Goldman Sachs, where she serves as Program Director for the "10,000 Women" initiative.

Sponsoring organizations for the Demos event included Ms. Foundation for Women, the National Council for Research on Women, Women Thrive Worldwide, The New York Women's Foundation and the Financial Women's Association of the New York Women's Agenda.

The Pax World Women's Equity Fund is the only fund in the United States to apply a gender-based investment strategy. The Fund seeks long-term capital appreciation by investing primarily in companies that in addition to meeting Pax World's other financial, environmental and governance criteria, take affirmative steps to advance women's equality in the workplace, promote women to top executive positions, have female representation on the board of directors and in senior management and present positive images of women in their advertising, promotion and marketing. ■

[1]Source: Catalyst study, "The Bottom Line: Connecting Corporate Performance and Women's Representation on Boards," December 20, 2007.
[2]Source: "Women in the Executive Suite Correlate to Higher Profits," Roy D. Adler, Ph.D. Pepperdine University, November 16, 2001.
[3]Source: Adams, Renee B., Ferreira, Daniel, "Gender Diversity in the Boardroom," Stockholm School of Economics, August 2004.

Shareholder Corner

President Obama's Stimulus Package Includes Making Work Pay Tax Credit

The "Making Work Pay" tax credit, part of the American Recovery and Reinvestment Act of 2009, has provided tax relief for individuals and families in the United States this year. The bill, which was the cornerstone of President Obama's economic stimulus legislation, reduces taxes for more than 95% of working families in the United States, providing an increase in take-home pay for the majority of Americans. Taxpayers can receive this benefit through a reduction in the amount of income tax that is withheld from their paychecks, or by claiming the credit on their tax returns.

The refundable tax credit is calculated at the rate of 6.2% of earned income (phases out for taxpayers with adjusted gross income in excess of $75,000 and $150,000 for married couples filing jointly). The credit limit is $400 for working individuals and $800 for working families.

For most families, this tax credit will add approximately $40 per month to a worker's paycheck. Have you considered using this opportunity to invest the additional money you may be receiving in your paycheck?

An easy and efficient way to make this investment is through a Pax World Automatic Investment Plan (AIP). With as little as $50 per month you can set up an AIP into any one of the seven Pax World Funds or the Pax World Money Market Account. For information on setting up an AIP visit www.paxworld.com or call 800.372.7827.

Automatic investment plans do not assure a profit and do not protect against loss in declining markets. Please note that the information contained in this article does not constitute investment or tax advice. Always consult your tax advisor before making any tax-related or investment decision.

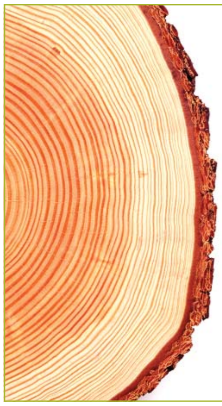
Act Allows for Suspension of RMD payments

In December 2008, the Worker, Retiree and Employer Recovery Act of 2008 was passed, allowing IRA shareholders who are 70½ or older, and are receiving or are due to receive Required Minimum Distributions (RMD payments), to suspend those payments for 2009 without penalty.

Under the Act, if you would normally be required to take an RMD payment in 2009, you may defer it without penalty until no later than December 31, 2010. This date applies even if you are turning age 70½ in 2009 and were planning to delay your first distribution until April 1, 2010, in accordance with IRS rules.If you started withdrawing an RMD from your Pax World IRA account in previous years through systematic withdrawals, you will continue to receive a distribution. If you choose to suspend your systematic withdrawals for 2009, you will need to complete and return a Systematic Withdrawal Discontinuance Form (request a form by calling 800.372.7827).

In light of the current market conditions and the complexity of the RMD rules, we suggest you consult with your tax or investment advisor to assist you to determine the course of action best suited to you. You may obtain a copy of IRS Publication 590 ("Individual Retirement Arrangements") by calling the IRS Forms Distribution Center toll free number at 800.829.3676 or visiting www.irs.gov.

Please note that the information contained in this article does not constitute investment or tax advice. Always consult your tax advisor before making any tax-related or investment decision.



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It's easy to sign-up today. Simply go to www.paxworld.com and login to Account Access, choose E-Delivery from the Email/Account Admin menu at the top, and follow the on-screen instructions.

[1]Co-op America's WoodWise Consumer Guide, 2001 Edition, available at: http://www.coopamerica.org/PDF/WoodWiseConsumer2001.pdf