VALUES

Walden Asset Management ❁ Investing for Social Change Since 1975

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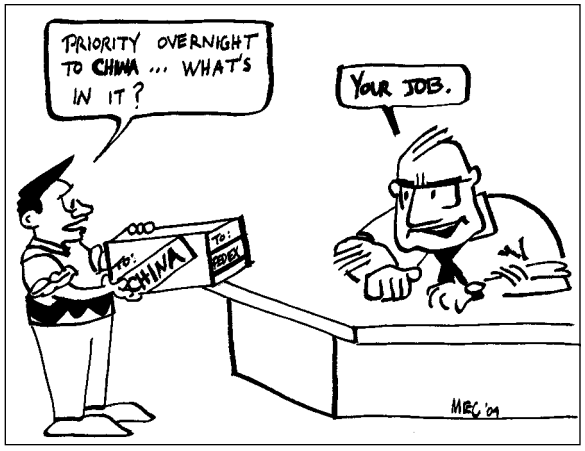
WHOSE RECOVERY?

What sort of economic recovery is this anyway? Readers of our quarterly investment memos know that we have been enthusiastic about the prospects for the stock market for nearly a year now. That's because history teaches that equities markets usually thrive when the economy rebounds from one of its periodic cyclical downturns. But beyond the strong recovery in the profits of big companies—up about 20 percent in 2003 (although still well below pre-recession levels)—one might fairly ask if this recovery is just a Wall Street fantasy or a politician's deception.



The strange nature of the recovery has been widely reported, and exhibit number one is the absence of job growth. *(See chart on page 6.)* In a typical recovery, the economy by now would have added 2 or 3 million jobs, but the government statistics that Federal Reserve Chairman Alan Greenspan says are most reliable report that employment only really began to grow in the last six months or so. The tally comes to just a few hundred thousand. Well, is this at least a normal recovery for those already employed? Hardly. Wage advances have followed an identical pattern. Despite booming productivity, rebounding profits, and 4.3 percent GDP growth, wages edged forward just 1 percent after inflation in 2003. For the two years of so-called recovery they are about flat. That compares to a 9 percent average rise in prior recoveries. Thus, the trend in wages only confirms the picture of a stunted recovery.

What should we make of this picture of an "investors only" jobless recovery? In some ways the situation is better than it looks, especially when viewed over the long haul. The recent failure of the U.S. economy to create jobs may prove but a brief setback in an extraordinary 20-plus year job creation boom. Over that period, U.S. jobs grew by 37 percent while population grew just 24 percent. One key statistic, the share of working age population employed, is now about 62 percent, only two points from the peak figure reached in 2000, and well ahead of the 59 percent level achieved prior to the recessions of the early 1980s. Even today's unemployment rate of 5.6 percent, while up sharply from the 4 percent level at the economy's peak in early 2000, remains low compared to other industrialized economies and far below the figures of previous recessions. And, all in all, the 2000-2001 recession eliminated fewer jobs relative to the size of the work force than past downturns.

But the secular trends should not provide too much comfort. While in some

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About Walden Asset Management

Walden Asset Management is the socially responsive investment division of Boston Trust & Investment Management Company. Walden began offering socially responsive investment services in 1975. We are among the largest and most experienced investment managers specializing in services for individual and institutional investors with social concerns.

About This Newsletter

This newsletter is designed to share our thinking about trends and issues in socially responsive investing and to generate dialogue with our readers. We invite you to comment on any article in the newsletter by calling your portfolio manager (617-726-7250) or by writing to Heidi Soumerai or Meredith Benton, co-editors, at the following address: Walden Asset Management, 40 Court St., Boston, MA 02108. Fax: (617) 227-3664.

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CLIMATE RISK ON INVESTORS' AGENDA

On November 21, 2003, I co-chaired the first *Institutional Investor Summit on Climate Risk* at the United Nations. There were nearly three hundred participants—institutional investors, financial industry leaders, advocates and experts—who came together to discuss the financial risk posed by climate change. It was a remarkable gathering, and truly a milestone in the rapid evolution of this issue in the financial industry.

To hold such a meeting just a few years ago would have been virtually unthinkable. What has changed?

First, scientific evidence is more strongly supporting the notion that levels of greenhouse gases are rising rapidly and will continue to do so, creating adverse effects on our physical environment and public health. In fact, a recent Pentagon report stated that climate change, and in particular, the potential for abrupt climate change "should be elevated beyond a scientific debate to a U.S. national security concern."

Denise L. Nappier is Treasurer of the State of Connecticut and principal fiduciary of the $20 billion Connecticut Retirement Plans and Trust Funds. She is one of the nation's leading advocates for corporate governance reform, including disclosure of the financial risks posed by climate change.

Secondly, increasing government actions to limit greenhouse gases have raised the visibility of this issue. Around the world, more than 100 countries have ratified the Kyoto Protocol, and in the U.S. numerous states are beginning to more forcefully grapple with the issue. For example, Massachusetts and New Hampshire have enacted legislation capping power plants' greenhouse gas emissions and the Governors of eleven states have pledged to reduce carbon dioxide emissions significantly.

That said, why would I, as Treasurer of the State of Connecticut with principal fiduciary responsibility for the $20 billion Connecticut Retirement Plans and Trust Funds (CRPTF), be concerned about an issue like climate change – and why should investors include climate change on their agenda?

First and foremost, investors are entitled to know about how their portfolio companies conduct themselves. For many of our portfolio companies, the consequences of climate change, if not properly managed, could adversely affect their bottom line and therefore the long-term performance of our investments. For example, companies could face the prospect of losing their competitive edge, incurring litigation costs, making capital investments that lose value due to new government policies, and/or dealing with additional unforeseen capital expenses.

All of these factors—and others—can erode shareholder value and place today's seemingly solid investment in jeopardy for the hundreds of thousands of Americans who rely on these investments for their future financial security.

It is appropriate that shareholder interest in climate change is growing. At the *Summit,* I joined with trustees from 9 other U.S. pension funds—representing $700 billion in assets—to issue a comprehensive 10-point "Call for Action." The landmark statement calls for tough new steps by the Securities and Exchange Commission (SEC), corporate boards, and Wall Street firms to increase corporate disclosure of the investment risks posed by climate change. This group also announced the formation of a new *Investor Network on Climate Risk* (www.incr.com) to follow through on the Call for Action, and that organization is up and running.

Additionally, shareholder resolutions on climate change were submitted to 31 U.S. companies in 2003, receiving shareholder support as high as 32 percent. These resolutions serve notice that shareholders are looking to corporations and their boards of directors to protect the long term value of our investments. The days of putting one's corporate head in the sand and waiting for the issue to pass are long gone.

The CRPTF was the first public pension fund to file a global warming resolution, which we did at American Electric Power (AEP) in 2001. Since that time we have been actively

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DOMTAR

cutting edge companies

This column highlights companies in the business of providing solutions to social and environmental challenges. Featured companies are typically held in the SmallCap Innovations portfolios offered to Walden's clients.

"Half the world's forests are now gone, and well over 30 million acres more are lost each year. In the United States, more than half our national forests have been logged, mined, or otherwise industrialized." This comment by the Natural Resources Defense Council is typical of the disturbing reports issued regularly by leading environmental advocacy groups. Environmentalists, consumers, socially responsive investors, and other stakeholders have pushed corporate consumers to adopt more environmentally sensitive purchasing policies. Success stories include new timber sourcing standards at The Home Depot, recycling programs at Staples, and packaging standards at Nike.

As customers alter their purchasing habits, forest products companies have responded. One well-regarded initiative to certify sustainably harvested timber is the Forest Stewardship Council (FSC). Certifiers for the non-profit FSC—a network with affiliates in 40 countries—audit forest management activities and track the "chain of custody" of certified forest products.

Domtar Inc. is the largest North American forestry company to make paper that meets FSC standards. Based in Montreal, Canada, Domtar manages 22 million acres of forestland and operates 11 mills in the United States and Canada. Among the well-known products using Domtar FSC-certified paper are some of the *Harry Potter* books. Already 17 percent of Domtar's timberland is FSC certified, although only a small portion of its revenues come from sales of FSC-certified paper. Domtar has partnered with World Wildlife Fund (WWF) Canada, however, and aims to certify all of its forestland to FSC standards in the coming years. A representative of WWF Canada told Walden that Domtar is a well-run company that has the systems in place to move forward quickly with FSC standards.

The U.S. forest products industry has its own Sustainable Forestry Initiative (SFI). According to the Maine Audubon Society, the FSC and SFI standards are similar with regard to protection of soil productivity, water quality, and harvest rates. However, they note that FSC standards exceed those of SFI with regard to biological diversity, forest chemicals use, plantations, exotic species, support for local communities and workers, indigenous peoples rights, and reporting. ◆

—K. Scott and J. Frame, Walden Intern

Ken Scott is a research analyst and portfolio manager of Walden's SmallCap Innovations portfolios.

CLIMATE RISK

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pursuing corporate disclosure on climate change in a variety of ways. We are pleased to be working closely with Walden on this issue, and this year co-filed resolutions at AIG and Chubb.

Are corporate mindsets changing? They are.

In a recent major breakthrough, AEP and Cinergy, leaders in the electric power industry, agreed to report publicly on how they are responding to growing pressure to reduce greenhouse gas and other emissions. The company reports, as developed by independent board members, will assess the impacts of and potential responses to a number of public policy scenarios. These are precedent setting agreements which we hope will be emulated by other companies and other industries.

Unquestionably, more needs to be done, and at the Connecticut Treasury, we are committed to doing our part. We understand that this effort will not succeed without many partners. The work of corporations, fund managers and financial analysts, legislators and regulators, as well as investors, is intertwined and interdependent. Only with a concerted effort will we truly succeed in protecting the long-term value of our investments and our economic well-being. ◆

SOCIAL RESEARCH AND ADVOCACY IN ACTION

Glass ceilings, climate change, corporate non-discrimination policies, labor standards, human rights, director elections. These are some of the issues Walden is tackling on behalf of our clients through shareholder actions—primarily corporate dialogues and proxy resolutions—in pursuit of greater corporate responsibility. (See *Selected 2004 Shareholder Initiatives* below.) As in previous years, our 2004 initiatives are moving ahead with mixed results: several clear victories, a number of "works-in-progress," and some corporate opposition.

Successful negotiations have led to the withdrawal of four Walden-led shareholder resolutions thus far in the 2004 proxy season. **Stryker** and **Dover** adopted inclusive nondiscrimination policies that explicitly prohibit discrimination based on sexual orientation. A hopeful backdrop to the divisive national debate on gay marriage, these companies now join the more than 70 percent of Fortune 500 firms with inclusive policies, according to the Human Rights Campaign.

SBC Communications and **Bell South** agreed to corporate governance reform on director elections that promote greater board accountability to shareholders. Both companies adopted a new policy to place the entire board of directors up for election each year, as opposed to putting a portion of directors up for election annually in a staggered or classified board structure.

These four companies' changes represent shareholder actions that led directly to adjustments in policies, important corporate change victories that never appeared on the proxy ballots. But there are other kinds of success stories too. Walden's first resolution to go to a shareholder vote this year, a proposal calling upon **Costco** to move to annual director elections, passed with the support of nearly three-quarters (226 million!) of the shares voted.

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Heidi Soumerai is Director of Social Research.

Meredith Benton is a member of Walden's social research and advocacy team.

SELECTED 2004 SHAREHOLDER INITIATIVES

ISSUE	COMPANY
ENVIRONMENTAL IMPACT	
Climate Change	American International Group***, Apache, Chubb***
Recycling	*Alberto-Culver, IBM*
Water Scarcity	Intel**
EQUALITY	
Investment banking criteria	Lehman Brothers**
Nondiscrimination policy	Alltel*, Dover*, Exxon Mobil, Stryker*
Equal Employment Opportunity	Amgen, *Respironics,* Wal-Mart
GLOBAL LABOR/HUMAN RIGHTS	
Vendor Standards	TJX Companies
HIV/AIDS Reporting	*Colgate Palmolive,* PepsiCo
Child Labor	*Home Depot*
Human Rights Policy	Exxon Mobil*
CORPORATE GOVERNANCE	
Staggered Board	Avon Products, Bell South*, Costco (73% Vote), Gillette, SBC Communications*, TJX Companies, Yum! Brands**
Executive Compensation	JP Morgan Chase**
Impact of Merger	*Bank of America*
Board Diversity	Bed, Bath & Beyond

* Withdrawn by proponent
** Filed on behalf of client only
*** Resolution omitted at the SEC
In dialogue with company, no resolution has been filed

SOCIAL RESEARCH AND ADVOCACY IN ACTION

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Costco co-founder and board member Jeff Brotman committed to study the issue and report back to shareholders within the year. Brotman subsequently told a reporter that he believes Costco's board does not need to be changed but that "the pendulum is swinging because so many corporate boards were corrupt." (Twin Falls, Idaho, *Times-News Online,* 2/4/04.)

A relatively new dialogue has emerged with the announcement last fall of the proposed mega-merger between **Bank of America** (BofA) and **FleetBoston Financial.** Coordinated by Boston Common Asset Management, Walden and other investors have been talking with senior executives to address the impact of the merger on employment, community reinvestment, philanthropy, environmental stewardship, and other issues. BofA and FleetBoston have engaged with investors in an open and respectful manner. Examples of their commitment include maintaining the current employment levels of FleetBoston in New England; pledging $750 billion to community reinvestment and $1.5 billion in philanthropic grants over 10 years; and continuing to be an active endorser of the CERES environmental principles. We are evaluating these and other commitments to understand their likely impact on programs currently in place.

Also, for years Walden has been watching both banks for progress in equal employment opportunity and diversity, especially after BofA's previous merger with the former NationsBank. BofA has promised to continue to share detailed diversity statistics, consistent with an agreement made with Walden in 2002. Moreover, BofA articulated a goal to "have diversity in senior management mirror our middle management diversity within five years," a novel and exemplary approach to remove glass-ceilings faced by women and people of color.

There is also progress in a continuing Walden-led discussion with **The Home Depot,** calling for assurance that handmade carpets sold in its Expo stores are not made with illegal and egregious child labor. The home improvement giant has hired an outside consultant to evaluate the independent monitors of carpet looms, such as RUGMARK, and has affirmed its intention to partner with one after concluding its due diligence.

Finally, as is true every year, we sometimes face obstacles in our corporate initiatives. Our efforts to engage **American International Group** and **Chubb** in a dialogue on insurance industry risks and opportunities associated with climate change resulted in shareholder resolutions that were omitted by the Securities and Exchange Commission (SEC) on "ordinary business grounds." Fortunately, Chubb and AIG are keeping the door open for continued shareholder input. And there is a silver lining: The SEC decision to exclude our resolutions is fuel for institutional investors who are seeking changes in SEC rules to strengthen corporate environmental disclosure. ◆

—H. Soumerai

WHEN CHANGE IS GOOD

When Walden reviews companies it asks a number of questions. What are our concerns? Are we able to engage management on issues of concern while simultaneously enhancing shareholder value? How does the company respond to problems when they arise?

As virtually all companies are yin/yang mixes in the area of social responsibility, we regularly reassess our research and often see our concerns as opportunities to support positive change through engagement.

AN ILLUSTRATIVE NARRATIVE

When Walden first reviewed Pfizer in 1994 it was excluded from most client portfolios. Pharmaceuticals is a high impact industry in terms of product safety and the environment, and concerns existed that Pfizer was lagging behind industry peers. Among the reasons cited; in 1991 it was fined $3.1 million for dumping violations, at the time the largest fine awarded under the Clean Air Act; and in 1992 the company paid $215 million to settle a class action suit with patients who had received fragile heart valves.

However, Walden's social research team reassessed and then approved Pfizer in 2000. The company's environmental performance had improved greatly; it had a strong record on workplace issues, particularly hiring and advancing women; it was a leader in corporate governance; and it was excellent in responding to investor concerns and inquiries. From that time, Pfizer has continued to take positive steps.

Examples of a changed Pfizer abound. In 2003 Pfizer's board recommended that shareholders vote for a resolution to declassify the board, an issue Walden had earlier raised with the company. Pfizer has also set a goal to reduce greenhouse gas emissions by 35 percent per dollar revenue from 2000 to 2007. Pfizer's was one of the most thoughtful responses Walden received to our compensation survey, a taboo subject for most companies. Walden regularly exchanges correspondence with a senior corporate governance executive and with Hank McKinnel, Pfizer's CEO.

All this is not to say that Pfizer is a perfect company—there is no such entity—and Walden continues to speak with management about a variety of issues. The difference between now and 1994 is Pfizer's demonstrated dedication to continuous improvement on environmental, social, and corporate governance issues. And, of equal importance, its responsiveness to shareholder input.◆

—M. Benton

WHOSE RECOVERY?

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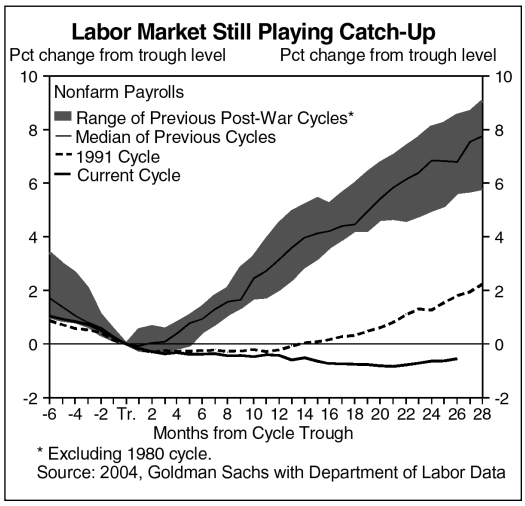
respects cyclical, the recent rise in the unemployment rate actually hides some disturbing developments. The first is that unemployment figures surely understate the distress among families and the malaise in the economy. Not counted among the unemployed are those 5 million working age Americans who have dropped out of the labor force in the past three years. We can be fairly certain that most of these did not do so willingly. They include sharply increasing numbers of persons collecting Social Security disability checks, a rising trend dating back to the 1980s. If we add the rise in these recipients over the last ten years to the reported unemployment rate, it would push the figure nearly one percentage point higher. Sadly, our booming prison population also perversely keeps the unemployment rate from looking worse. If we took the increase in inmates over the past ten years and added that population to the job-seekers' rolls, it would increase the unemployment rate by about 0.4 percent.

Perhaps most telling, the total share of the prime work age population, those between the ages of 25 and 54, who are either working or looking for work has slipped below 83 percent for the first time since the 1980s. Indeed, labor force participation is down among virtually every demographic group reported by the Bureau of Labor Statistics with one disturbing exception: those over 55. Since the recession began, labor force participation among older persons has risen three percentage points to 36 percent. We can assume that much of this rise stems from people forced to return to work because of disappointing pension benefits, rising healthcare costs, or low interest rates that have depleted income from their savings.

So where should we focus our attention, on the long-term trend in job growth or these disturbing, but generally more recent developments? At the very least, the evidence suggests that the American economy faces extraordinary challenges in creating jobs over the coming years. The very dynamism that has contributed to our prosperity—and especially stock market wealth—guarantees these challenges. When we look at the growth or loss of total jobs alone, we miss the two components underlying the equation: jobs created and jobs lost. The size of these two figures is breathtaking. In a typical month well over 3 million U.S. workers lose or voluntarily leave their employment, while, in normal times, a similar number of workers are hired. The rising productivity that is the lifeblood of economic progress only speeds this process, making any mismatch between job creation and destruction ever more painful. And with technological advances, especially the spread of high-speed global communications, the premium that will be placed on the newest skills and the most flexible workers—whether located domestically or abroad—is sure to be ever higher. Those workers cast aside by these changes will suffer joblessness or low wages. Even if total employment once again begins to rise, we are likely to see the pace of job destruction gain, the persistence of unemployment for those unable to adapt increase (the average period of unemployment for the jobless is today almost 20 weeks, near a 25 year high), and the sense that this economic recovery is mostly for shareholders instead of workers become more pervasive.



These trends may well be inexorable. What we do about them is something else. Government actions in the form of tax policy, or education and welfare reform can be used to slow these trends or ameliorate their impact. Progressive companies might improve their own prospects by smoothing the transition for their workers. Or, we can accept the standard free market nostrum that the market will sort it all out. With the presidential and congressional elections this fall, there should be no shortage of opportunity to debate the issue. And politicians will have the chance to prove that they understand that this Wall Street recovery has little bearing on the long-term jobs issues facing the U.S. economy. ◆

—B.Apfel

Bill Apfel is a senior portfolio manager and Director of Securities Research.

QUITMAN TRI COUNTY FEDERAL CREDIT UNION

community development investing

Color Me Happy Daycare is a childcare and pre-kindergarten educational provider in Batesville, Panola County, Mississippi. Established in 1990, the center is owned and operated by Donna Traywick, a native of Batesville, Miss. The childcare facility is licensed for 61 children ages 2 to 12 years of age, and provides childcare services but also piano, guitar, and ballet lessons and other extracurricular activities.

Color Me Happy Daycare is community-minded and the children who attend participate in many charity events and activities, such as Cancer Society Relay for Life, Holiday House at Chamber of Commerce, Love Lights, Food Pantry, and Coats for Kids. Quitman Tri County Federal Credit Union (QTCFCU) is happy to have been able to assist Donna Traywick, and other business leaders like her, in making a difference in children's lives as well as in the community in which we live.

In 2002, Traywick needed an additional building constructed next to the existing one for the after school services and extracurricular activities her daycare provided. She received financial assistance from the Quitman County Development Organization's Micro Loan Program to pay for the new building for her expanding business. But soon after that, with the downturn in the economy, many parents were laid off. Attendance at her daycare dropped as unemployed parents took up caring for their children themselves. She began having problems making payments on loans, making payroll, and keeping up with federal regulatory guidelines. That is when Quitman Tri County Federal Credit Union stepped up to help keep her business afloat. Many parents still depended on Traywick because they knew she ran a quality daycare with a very competent staff.

Ms. Traywick, left, stands in front of Color Me Happy with Pam McNutt, a QTCFCU employee.

With so many families having both parents working, daycare is the primary option for the working class families in the community. Color Me Happy Daycare provides a vital service and Quitman Tri County Federal Credit Union didn't want it to end, as the need would again increase when the economy improved. Traywick first contacted the local office in Sardis, Panola County, Miss., which is part of QTCFCU's field of membership. Barron Webb, the branch manager, worked with her to figure out what she would need and walked her through the process of obtaining an additional loan to consolidate some existing debt. Today, the daycare is doing well, attendance is back up, and Traywick is optimistic about the future of her business.

The Quitman Tri County Federal Credit Union was founded in August 1981 to meet the need for access to credit of low-income residents in Quitman County (located in the Mississippi Delta), who were historically denied adequate financing from local banks and who relied on finance companies that charged high interest rates. Quitman Tri County Federal Credit Union's quest to serve the underserved is ongoing. By branching out to the other counties such as Panola, Tallahatchie, and Coahoma, QTCFCU now helps more families and businesses in this economically underdeveloped area. The credit union offers saving accounts, personal and automobile loans, credit cards, ATM cards, money orders, and various other financial services. Color Me Happy is just one of QTCFCU's success stories. ◆

-N. Shoemaker

For more information about QTCFCU, please contact Nanette Shoemaker, Internal Operations Officer, at (662) 362-4000.

Through our Community Development Investment Service, Walden clients have invested over $8 million in community development banks, credit unions, and loan funds. We are pleased to have included Quitman Tri County Federal Credit Union in this service.

THE WALDEN COMMUNITY

Shared Interest, sponsor of the Thembani Fund, one of the community development investments of Walden clients, is celebrating its 10th anniversary – and that of South Africa's democracy – by organizing a delegation to South Africa in April. The Fund provides capital to guarantee South African bank loans to communities of color previously considered "unbankable." Senior Walden portfolio manager Stephen Moody is packing his bags to return to South Africa with the delegation after an 18-year hiatus. He will meet with South Africans at the grassroots and national levels to observe first hand the country's achievements in its first decade of political democracy, as well as the challenges that remain. Stephen will visit several Shared Interest partner organizations working in micro-finance, low-cost housing and rural development. Sure to be a highlight is a visit in Soweto with President Mandela.

Two years ago Walden helped Amnesty International USA (AIUSA) file the first resolution in their history, asking Exxon Mobil to adopt and implement a human rights policy to govern global business operations. Still a leader in this dialogue, joined by the AFL-CIO, AIUSA reports significant progress. Exxon Mobil has agreed to declare its commitment to the principles of the International Labor Organization Declaration in forthcoming public reports and to implement these principles in its operations – an important recognition of international labor rights. We are grateful to AIUSA and the AFL-CIO for this initiative, and to Exxon Mobil for this step that recognize the importance of strong labor standards in the global economy.

The **Walden Social Equity Fund** (WSEFX) and **Walden Social Balanced Fund** (WSBFX) continue to demonstrate that socially concerned investors can and do achieve highly competitive financial results.* *Morningstar* gives Walden Social Equity top marks with its 5 star rating, noting its high return with below average risk over the most recent three year period (ending 2/29/04) among the 1,568 funds in the *Large Blend* category. Similarly, *Morningstar* awarded Walden Social Balanced its next highest rating of 4 stars for having above average return and low risk relative to its *Moderate Allocation* category of 939 funds over the same three-year period ending 2/29/04. Walden is pleased to help demonstrate that good performance and positive social impact are compatible investment goals.

Past performance does not guarantee future results. The performance data quoted represents past performance and current returns may be lower or higher. The investment return and net asset value will fluctuate so that an investor's shares, when redeemed may be worth more or less than the original cost. To obtain performance information current to the most recent month end, please call 1-800-282-8782 x7253. Morningstar proprietary ratings reflect a risk-adjusted return that accounts for variation in a fund's monthly performance (including the effects of sales charges and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive 5 stars, the next 22.5% receive four stars, and the next 35% receive three stars. The funds do not have a 5 or 10-year rating. Boston Trust Investment Management, Inc. is the adviser for WSEFX and WSBFX and a wholly owned subsidiary of Boston Trust & Investment Management Company (Boston Trust). Walden Asset Management is the socially responsive division of Boston Trust. An investor should consider the fund's investment objectives, risks, and charges and expenses carefully before investing or sending money. This and other important information about the investment company can be found in the fund's prospectus. To obtain a prospectus, please call 1-800-282-8782 x7050. Distributed by BISYS Fund Services. Please read the prospectus carefully before investing. ◆

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