

Mutual Funds Disclose Proxy Votes

For all but a few socially responsible mutual funds, the world has changed. Mutual funds were required by August 31 to disclose how they cast their corporate proxy votes. Most socially responsible mutual funds have been doing this for some time. For them, it will be business as usual. For others, more than a few secrets were revealed.

Unchanged was the long-standing obligation to vote proxies in the best interests of clients, yet until now the proxy votes of the almost \$4 trillion of stock owned by mutual funds were secret, with mutual fund shareholders not knowing how their fund had voted. Think of proxy voting as absentee balloting in corporate form, conducted so that shareholders do not have to be physically present at corporate annual meetings to have their ballots represented.

Few annual meetings have been so widely attended as that of The Walt Disney Company, where Disney CEO Michael Eisner, 62, was a target accused of excessive pay, poor leadership and failure to resuscitate the company's share price. Only a slight majority of shares were voted in his favor, a level of dissent that rarely occurs for any corporation. Fidelity's mutual funds voted against him, while Vanguard voted to reelect him.

As a sidenote, shareholders when electing corporate directors are presented with two choices: for and withhold. It requires only one "for" vote to elect a director, no matter how many "withhold" votes are cast, as long as the election goes uncontested as is usually the case. This is why management's power to nominate directors is so overwhelming. Management's nominees nearly always win!

Many mutual funds outsource their proxy voting to consultant Institutional Shareholder Services and rarely, if ever, overturn these recommendations. This year, anti-takeover defenses, lavish management severance packages and poorly run corporate boards were voted against. Also typically voted down by conventional mutual funds were proposals submitted by shareholder activists, as opposed to those supported by management. Not supported, except among the ethical fund set, were social and political initiatives. For example, the Putnam Voyager fund sided with Wal-Mart's management and voted against specific sustainability and diversity reporting requirements.

The Securities and Exchange Commission is considering rules that would allow dissenting shareholders to nominate candidates if certain "triggering events" or standards are met. An example of such an event would be the 45% of votes withheld from Eisner, who as a result retained his directorship but lost his position as Disney's chairman. Last Friday, he announced his retirement effective September 2006, a wait too long for many of his critics.

"We have no obligation to make history. We have no obligation to make art. We have no obligation to make a statement. To make money is our only objective."

-- Michael Eisner, CEO, The Walt Disney Company, wrote in a memo sent during his previous position at Paramount.

For a long time, corporate governance watchdogs and socially responsible investors had lobbied the SEC to pass proxy voting disclosure rules. In a failed effort to forestall such changes, the chairmen of the two largest mutual fund complexes, Vanguard and Fidelity, jointly wrote a *Wall Street Journal* editorial to oppose disclosure. The two chairmen sought to avoid what they called "becoming an arbiter of political and social disputes." As a result of public disclosure, activist groups with an "ax to grind with corporate America," they feared, would pressure mutual funds and distract investment managers from the business of making money. Not fair, both chairmen complained, private institutional investors such as pension funds, insurance companies and foundations are not required to disclose their votes.

How did your mutual fund vote?

Check out the SEC's EDGAR search tool on the web at www.sec.gov. Enter the mutual fund's name and "N-PX", the title of the proxy voting disclosure form.

You use a derailleur when you shift between gears on a modern bicycle. This is achieved by leading the chain from one sprocket to another. Just look where the chain wraps around the sprockets attached to your rear wheel, and there you will find the derailleur, a device that aids in the achievement of forward progress and momentum.

At the time of the rule's passage in January 2003, the political environment was such that special interest groups were powerless on Capitol Hill to force a halt to the SEC's reforms. Public opinion had become enraged by corporate scandals and excesses, some occurring with the tacit approval of investment managers.

The SEC had also been tarnished for its failure to prevent a wave of corporate abuses and a discredited Chairman Pitt departed in 2002. Over the past two years, as threats from Congress to slash the agency's budget or cut its regulatory authority have receded, the SEC under Chairman William Donaldson has implemented reforms to provide greater disclosure and more aggressive oversight. In several controversial rulemaking decisions, the Republican Donaldson allied with the SEC's two Democratic commissioners against his two fellow Republicans.

Public disclosure of proxy voting should make investor relations meetings more interesting as mutual fund managers engage with managements whose initiatives or board appointments they voted against. It will make more democratic the process in which investment managers represent the interests of their clients, the owners of mutual funds, through proxy voting. ❖

<i>Market Data, as of September 10, 2004</i>	
GDP growth (real):	4%
Inflation (CPI):	2%
S&P 500:	1124
P/E, trailing (S&P):	20
10 year Treasury note:	4.2%
Yield spread (10+ yr. A/BBB corporate bond less Treasury bond):	1.2%
Dollar:	1.23 U.S. dollar / euro
Oil:	\$43 / bbl.
Gold:	\$402 / oz.
Consensus for equities (what most investors believe or feel):	Markets have come too far to fall back now! It's time to make progress. Stick with quality and gains will return.
Consensus thinking on the economy:	Growth trends too powerful to derail. Faltering in consumer and tech spending is temporary.

"We got different varieties of seeds to plant. We were also provided with technical visits on a weekly basis and some training too. I give the vegetables we grow for my wife to cook in order for my children to have proper and healthier nutrition, sturdy growth and to study better. The veggie production helped me with finance. And now, I no longer need to buy them, but instead I grow them organically."

-- Pedro Bolon, Mayan farmer, Belize



Sustainable Harvest International is working with more than **700 families** in **Honduras, Panama, Belize and Nicaragua** implementing alternatives to slash-and-burn farming, the leading cause of rainforest destruction in the region. Working with local field personnel trained by SHI, our participants have:

- Converted **thousands of acres** of degraded land to sustainable uses
- Increased families' **annual incomes from \$500 to \$4,000** due to new farming and marketing skills
- Worked with **dozens of schools** on organic gardening and reforestation projects
- Planted over **1,000,000 trees** and built wood-conserving stoves

The technologies that we promote are intentionally inexpensive to establish and can therefore offer economic sustainability. Thus, each tax-deductible donation has a significant and lasting impact.

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