

# PRINCIPLES

An Investment Newsletter



MAY 2004

## Market Commentary

### GLOBAL EVENTS

Following the strong gains of 2003, investors were made uneasy early in 2004 by relatively high stock valuations, terrorist incidents in Europe and the ongoing war in Iraq. Regulatory investigations and settlements by U.S. mutual funds, along with substantial fines for NYSE specialist firms, also kept investor skepticism at heightened levels.

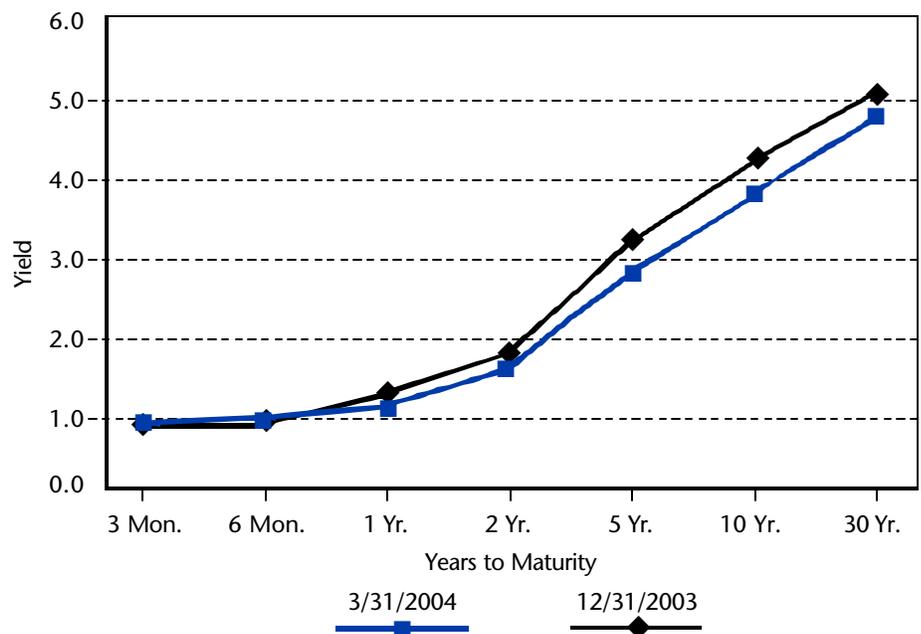
### MARKET IMPACT

The Japanese stock market surged by 15% in dollar terms, driven by 6.4% GDP growth in Q4 2003 and sizeable inflows of foreign cash. While exports to China have helped, a positive turn in consumer sentiment and household spending were encouraging. European markets — particularly Germany, France and the Netherlands — produced weak results due to persistent high unemployment, weak business confidence data and a 2.5% decline in the Euro vs. the dollar. The U.K. stock market declined in local terms on weakness in banking, consumer staples and service companies, although the Pound strengthened.

### EQUITIES

U.S. investors benefited from small cap and value style investing during the first quarter. While the S&P 500 rose 1.7%, the Russell 2000 Index gained 6.26% and the Russell 1000 Value Index rose 3.02% (compared to 0.78% for the Russell 1000 Growth Index). The strongest sectors in the

### Treasury Yield Curve



U.S. were consumer staples, energy, financials and wireless telecommunications (up 4% to 5%), while the weakest included the cyclical sectors — technology, basic materials and industrials (down 1.4% to 2.6%).

### BONDS

Sluggish employment growth supported the U.S. bond market this quarter, further reducing prospects for a Federal Reserve interest rate hike during 2004. Bond returns were competitive with large cap equities, as Treasury yields fell from 30 to 40 basis points for maturities beyond 5 years. Higher quality credits fared better than lower quality issues, while mortgage-backed issues suffered from

volatility during early March as interest rates unexpectedly dropped and re-financings surged.

### INFLATION

Inflation rose moderately from fourth quarter 2003 levels, driven primarily by sharply rising energy, transportation, and medical costs. First quarter core CPI rose 2.9%, a marked increase over the 1.1% core CPI increase during the full year 2003. ■

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# Fund Performance — First Quarter 2004

Fund Name	3 Months	1 Year	3 Years	5 Years	10 Years	Since Inception	Inception Date*
<b>RCT Money Market Fund</b> <sup>^^</sup>	<b>0.10</b>	<b>0.49</b>	<b>1.37</b>	<b>2.89</b>	<b>3.82</b>	<b>4.80</b>	<b>Jan-85</b>
Lipper Government for MM Funds	0.09	0.40	1.28	2.84	3.86	*	
Merrill Lynch 91-Day TBill Index	0.23	1.08	*	*	*	*	
<b>RCT Short Bond Fund</b>	<b>0.96</b>	<b>2.23</b>	<b>4.83</b>	<b>5.64</b>	<b>5.76</b>	<b>7.01</b>	<b>Jan-85</b>
Merrill Lynch 1-3yr Treasury Index **	0.99	2.33	4.63	5.54	6.07	*	
<b>RCT Interm. Diversified Bond Fund Class A</b>	<b>1.88</b>	<b>4.76</b>	<b>6.86</b>	<b>6.75</b>	<b>*</b>	<b>7.68</b>	<b>Jan-95</b>
Lehman Aggregate Index	2.65	5.40	7.44	7.29	7.54	8.18	
<b>RCT Interm. Diversified Bond Fund Class B</b>	<b>1.92</b>	<b>4.92</b>	<b>6.93</b>	<b>6.79</b>	<b>*</b>	<b>7.71</b>	<b>Jan-95</b>
Lehman Aggregate Index	2.65	5.40	7.44	7.29	7.54	8.18	
<b>CUIT Balanced Fund</b>	<b>3.52</b>	<b>28.91</b>	<b>7.51</b>	<b>6.93</b>	<b>10.72</b>	<b>10.25</b>	<b>Dec-83</b>
60% S&P 40% LBAgg †	3.33	24.09	3.80	2.53	10.24	10.08	
<b>CUIT Value Equity Fund Class A</b>	<b>5.75</b>	<b>46.99</b>	<b>8.36</b>	<b>6.04</b>	<b>*</b>	<b>12.85</b>	<b>Jan-95</b>
Russell 1000 Value Index	3.02	40.81	4.31	3.89	12.61	13.51	
<b>CUIT Value Equity Fund Class B</b>	<b>5.84</b>	<b>47.22</b>	<b>8.42</b>	<b>6.07</b>	<b>*</b>	<b>12.87</b>	<b>Jan-95</b>
Russell 1000 Value Index	3.02	40.81	4.31	3.89	12.61	13.51	
<b>CUIT Core Equity Index Fund Class A</b>	<b>2.20</b>	<b>36.93</b>	<b>1.36</b>	<b>(0.71)</b>	<b>*</b>	<b>12.08</b>	<b>Jan-95</b>
Standard & Poor's 500 Index ††	1.70	35.13	0.64	(1.18)	11.69	12.07	
<b>CUIT Core Equity Index Fund Class B</b>	<b>2.19</b>	<b>37.02</b>	<b>1.46</b>	<b>(0.64)</b>	<b>*</b>	<b>12.12</b>	<b>Jan-95</b>
Standard & Poor's 500 Index ††	1.70	35.13	0.64	(1.18)	11.69	12.07	
<b>CUIT Growth Fund Class A</b>	<b>1.46</b>	<b>28.23</b>	<b>(3.33)</b>	<b>(0.31)</b>	<b>6.24</b>	<b>9.76</b>	<b>Jan-91</b>
Russell 1000 Growth Index ^	0.78	32.19	(1.74)	(2.28)	7.78	10.25	
<b>CUIT Growth Fund Class B</b>	<b>1.54</b>	<b>28.59</b>	<b>(3.22)</b>	<b>(0.24)</b>	<b>6.28</b>	<b>9.79</b>	<b>Jan-91</b>
Russell 1000 Growth Index ^	0.78	32.19	(1.74)	(2.28)	7.78	10.25	
<b>CUIT Small-Cap Equity Fund Class A</b>	<b>3.86</b>	<b>60.42</b>	<b>2.85</b>	<b>7.85</b>	<b>*</b>	<b>10.16</b>	<b>Jan-95</b>
Russell 2000 Index	6.26	63.82	10.89	9.65	10.43	11.22	
<b>CUIT Small-Cap Equity Fund Class B</b>	<b>3.98</b>	<b>60.75</b>	<b>2.92</b>	<b>7.89</b>	<b>*</b>	<b>10.19</b>	<b>Jan-95</b>
Russell 2000 Index	6.26	63.82	10.89	9.65	10.43	11.22	
<b>CUIT International Equity Fund Class A</b>	<b>2.33</b>	<b>49.13</b>	<b>2.26</b>	<b>3.06</b>	<b>*</b>	<b>8.15</b>	<b>Jan-95</b>
MSCI EAFE-Gross Index	4.41	58.17	3.80	0.83	4.86	4.78	
<b>CUIT International Equity Fund Class B</b>	<b>2.44</b>	<b>48.90</b>	<b>2.64</b>	<b>3.43</b>	<b>*</b>	<b>8.36</b>	<b>Jan-95</b>
MSCI EAFE-Gross Index	4.41	58.17	3.80	0.83	4.86	4.78	

\* Data not available.

\*\* Benchmark Index: ML 1-3 Yr. Treasury Index eff. 7/1/01; ML 1-5 Yr. G/C Index eff. 7/1/97; 50% Lehman Intermediate Govt Index/50% Lehman 1-3 Yr. Govt Index eff. 5/1/96

† Benchmark Index: 60% S&P 500/ 40% LBAgg% eff. 1/2/03; 60% S&P 500/ 30% LBAgg/ 10% 91-Day T-Bill eff. 4/1/91; 60% LBAgg/40% S&P 500 in prior periods.

†† "S&P 500" is a registered trademark of McGraw-Hill Companies, Inc. ("McGraw-Hill"). The CUIT Core Equity Index Fund is not sponsored, endorsed, sold or promoted by Standard & Poor's and Standard & Poor's makes no representation regarding the advisability of investing in the fund.

^ Benchmark Index: Russell 1000 Growth Index effective June 1, 2000; prior to this date, historical returns reflect Russell Mid-Cap Growth Index.

^^ Peer Group: Morningstar Large Growth Fund Universe effective June 1, 2000; Prior to this date, historical averages reflect Morningstar Mid-Growth Fund Universe.

^^^ The RCT Money Market Fund changed its investment approach from overnight repurchase agreements, its approach since fund inception, to an actively managed MM portfolio effective 8/1/01.

• Performance for Class B shares includes performance of the Fund's Class A shares for periods prior to the issuance of Class B shares by the fund.

Performance for periods of one year and longer are annualized. All fund performance (including that of comparative indices) is reported net of any fees and expenses, but inclusive of dividends and interest. Past performance is not indicative of future performance. The return and principal value of the Fund(s) will fluctuate, and upon redemption, shares in the Fund(s) may be worth less than their original cost. The RCT Money Market Fund is not guaranteed by the U.S. Government and there can be no assurance that a stable net asset value of \$1.00 can be maintained. The comparative indices represent unmanaged or average returns on various financial assets which can be compared to the Funds' total returns for the purpose of measuring relative performance. Comparative index information is provided by Lipper Analytical Services, Inc., Morningstar Mutual Funds and Mellon Bank; information regarding composition of indices may be obtained from provider or CBIS. CBIS offers pooled funds on behalf of two not-for-profit investment trusts, Religious Communities Trust (RCT) and Catholic United Investment Trust (CUIT). Offering Memoranda / Disclosure Statements, which contain further information, are available by calling either 800-592-8890 or 800-321-7194. Such information should be carefully considered prior to investing in the Funds.

# CBIS Fund Commentary

## First Quarter 2004

### OVERVIEW

Globally, stocks posted strong returns during January, then stagnated as the quarter progressed. While earnings improved, economic data did not meet investor expectations, and in the U.S., increasing focus was placed on weak jobs data. Commodity prices, particularly those energy-related, continued to rise on strong demand from China and other raw materials importers. As the quarter ended, investors rotated from cyclically sensitive issues into more defensive sectors such as utilities and staples. Rising oil prices and a downward restatement of reserves at Royal Dutch Shell supported strong prospects for energy firms, while diversified financials and insurers saw improvements in capital markets and M&A activity, and earnings reports, respectively.

The Japanese stock market led the developed markets, boosted by data indicating a possible end to deflationary forces combined with improving in consumer sentiment and traditional fiscal year-end window dressing by the government. Among the strongest performers were financial issues, particularly large Japanese banks whose significant equity holdings were boosted by the market rebound. The consumer staples and discretionary sectors were also very strong, as retailing issues led the market upturn. Emerging market returns were positive this quarter, enhancing EAFE-based portfolio results in selective names such as Samsung and America Movil.

European markets were far more subdued, rising only 1% in dollar terms. Merger and acquisition activity had a significant impact on individual corporate returns, both positively and negatively; for some European banks with excess cash, their stock price

declined on the perception that they would consider dilutive acquisitions.

The U.S. dollar finally gained traction during the quarter, strengthening 2.5% vs. the Euro, as European business confidence indicators declined and investors assimilated the March terrorist bombing in Madrid. However, the dollar weakened further against the Pound (-2.7%) on economic strength and a Bank of England rate hike during February, and declined 3% against the Yen, as Japanese stocks surged and the Japanese economy seemed markedly stronger.

In the U.S. stock market, the interest rate sensitive utilities and financials sectors performed well, as did consumer staples, energy and wireless telecommunications. This reflected a degree of investor rotation out of the cyclical sectors, which had performed so well during 2003. Smaller cap issues continued to perform well both in the U.S. and abroad. Value style investing produced stronger results during the first quarter than did growth, particularly among larger issues.

While weaker employment data undermined stocks, it helped bonds close out a positive quarter. The Federal Reserve remained accommodative at its most recent meeting on March 16th, and afterward the bond market saw diminished odds of an interest rate hike before year-end. Treasury yields beyond five years in maturity declined 0.4% during the quarter. Credit spreads widened, particularly among lower quality issues, in part mirroring some the weakness in stocks during March. Foreign central banks, particularly Asian banks controlling their currency appreciation vs. the U.S. dollar, continued to support Treasury prices at shorter maturities.

### CUIT & RCT FUND PERFORMANCE

Fund performance during the quarter was moderate, reflecting growing investor concern about sustainable employment growth and inflationary pressures as the quarter progressed. The RCT Intermediate Diversified Bond Fund produced a 1.88% return, as longer duration portfolios outperformed cash and short bond programs, with interest rates declining by 0.4% over the period. The strongest performing CUIT program was the Value Equity Fund, up 5.75% for Class A shares; value style investing was more successful than growth this quarter, particularly among larger cap issues. International and small cap equity results generally enhanced large cap U.S. portfolio returns, although CUIT Small Capitalization Equity and CUIT International Equity Fund returns were relatively weaker than their benchmarks this quarter. The CUIT Core Equity Index Fund produced substantial added-value over its benchmark, as there was considerable benefit from the exclusion of large pharmaceutical and defense contracting companies, and substitution into better performing biotech, medical equipment and industrial issues.

### CBIS RECOMMENDED INVESTMENT ALLOCATION

During the first quarter of 2004, the CBIS Recommended Investment Allocation for a 60% equity/40% bond portfolio would have added 49 basis points over the 2.08% return of a 60% S&P 500 Index/40% Lehman Aggregate Index benchmark, net of fees. Diversification into small cap and international equities proved very beneficial once again this quarter. Active management augmented

returns within all of the large cap strategies, both active and passive; however, underperformance by managers within the small cap, international and bond programs reduced the total value of diversification alone. Over the trailing twelve months, diversification into small cap and international equity exposure benefited returns compared to the S&P 500, and the large cap value and growth style strategies also proved additive. Despite weakness in the small cap, international and bond programs vs. indices, net value added was 3.64% for the past year. For three years through March, diversification and active management have added 77 basis points, net of fees, on an annual basis.

#### ANALYSIS OF RECENT RESULTS

The stock market rally that began during the spring of 2003 has produced strong absolute returns for CBIS participants, and represents a welcome change from three years of negative equity market results. On a relative basis, however, several of our programs have lagged their benchmarks, reflecting, in large part, the recent strong performance of volatile, speculative securities contrasted with our risk-controlled, longer-term investment focus. This section of the commentary examines this in more detail, and provides an outlook for these programs over coming quarters.

#### CUIT Equity Programs

On the equity side, the weaker relative results over the past twelve months reflect several short-term factors. During the first year following a bear stock market, lower quality issues often perform quite strongly. This was evident in both the large cap and small cap areas, as many financially and operationally troubled companies, whose shares had fallen precipitously from their highs of early 2000, surged upward from depressed

levels on hopes that a strengthening economy would help them avert bankruptcy. CUIT sub-advisers generally avoid these highly speculative issues, and invest in financially strong and stable companies capable of credible, sustainable earnings growth. As equity markets return to more moderate growth, we believe that sustainable earnings and healthy ROEs will be more appropriately valued in stock prices. Market leadership is in fact now rotating to more sustainable growth companies, those that can translate past cost reduction and current market share into solid profit growth. Jarislowsky Fraser and Capital Guardian in the CUIT International Equity Fund, and RCM in the CUIT Growth Fund, were the sub-advisers most negatively affected by this market condition.

The Federal Reserve's extremely accommodative monetary policy has caused further anomalies in the equity market. One of the most dramatic has been the strength of REIT issues, up over 35% during 2003, and an additional 13% through March 31, 2004. With short-term interest rates below 1%, investors in search of yield have bid up REITs far beyond reasonable levels. The CUIT Small Capitalization Equity Fund's sub-advisers have substantially avoided this sector (representing 6% of the Russell 2000 Index) due to its high relative valuation, and this has created a meaningful short-term cost in terms of relative results. However, the REIT sector has stumbled sharply since early April; by mid-April it had lost all of its year-to-date gains and more.

Another significant factor affecting the performance of all CUIT equity programs has been the strength of small and mid cap equities vs. large cap issues; small cap stocks outperformed large cap by a factor of two to one during 2003, and that trend continued into the first quarter of 2004. This is typical of the early phase of an

economic recovery, and should wane as economic growth continues. The CUIT Growth Fund and International Equity Funds each have a large cap emphasis, and have given up relative return as a result. While each has a mandate to selectively weight mid cap or large cap exposure, seldom has the decision so significantly impacted results as in 2003.

#### RCT Fixed-Income Programs

Within the RCT bond programs, our sub-advisers have also adopted risk averse positions: on credit exposure by focusing on high quality credits, on interest rates by maintaining shorter portfolio durations, and particularly in regard to yield curve risk, by structuring portfolios with a pronounced bar belled structure. As demonstrated last summer, when the market perceives a possible shift in Fed interest rate strategy, the high degree of leverage in the bond market causes dramatic volatility. Our sub-advisers recognize that the bond market faces as much risk from volatility and yield curve flattening as from rising interest rates. This defensive positioning within the RCT Short Bond and Intermediate Diversified Bond Funds limited results in 2003 and during the first quarter of 2004, primarily by sacrificing yield vs. peers and benchmarks. However, given the losses to principal that are possible when rates rise and/or when the market's current risk tolerance wanes, and given the return possible from yield curve flattening and from strategies that can weather market volatility, CBIS believes that our sub-advisers are pursuing prudent, long-term approaches that will enhance yield while protecting principal. Moreover, such portfolio structures provide great liquidity to take advantage of opportunities that will inevitably arise when market volatility increases and credit spreads widen.

## Summary

We live in the “short term”, and especially with respect to investing, shorter-term results often shape our perspectives. While it is frustrating to experience such relative shortfalls in performance, we encourage participants not to lose sight of the fact that capturing the short-term gains of highly volatile, speculative securities, or “reaching for yield” in a low yielding bond market, entails a great degree of risk. As we review our sub-advisers and fund performance, we will not lose sight of the longer-term objectives of our funds, knowing that a risk-controlled, longer-term focus is a prudent, rational framework for identifying value in the financial markets. Many investors fail to achieve their goals because they give back hard won gains when markets decline, not because they fail to fully capture the periodic speculative surges in lower quality companies. As long as we have confidence in the investment professionals and investment process at each of our sub-advisers, we will retain them, and give them the time required for their approaches to produce meaningful results. And we will continue to analyze these results with a structured process that ensures our participants will attain their longer-term investing goals.

## *RCT Funds*

### **RCT MONEY MARKET FUND**

The Fund produced a 0.10% total return for the first quarter vs. a 0.23% return for the Merrill Lynch 91-Day Treasury Bill Index. Relatively tight credit spreads in the cash markets, and only modest additional yield from maturity extension, will continue to limit the prospects for cash funds until the Federal Reserve tightens its accommodative monetary stance.

There has been modestly greater

use of securities maturing in 90 days or more, now 36% of the portfolio, to augment fund income, as the yield curve currently steepens at 1.5 years in maturity. The portfolio remains of very high quality, and has a yield advantage over the benchmark of approximately 15 basis points achieved through longer, fixed and floating rate asset-backed notes, as well as shorter maturity Agency discount notes, floating rate corporate notes and commercial paper.

### **RCT SHORT BOND FUND**

The Fund slightly lagged its Merrill Lynch 1-3 Year Treasury benchmark this quarter, returning 0.96% vs. 0.99% for the benchmark. The Fund had a slight yield advantage of 20 basis points over its benchmark, resulting from moderate exposure to the mortgage, asset-backed and Agency sectors. This remains a very conservative portfolio structure, and is based on an assessment of the credit, volatility and interest rate risk present in the short-duration bond market. The barbelled structure of the portfolio added to results as the yield curve flattened by 22 basis points between the two and five year points of the Treasury curve. However, the Fund’s duration, at 0.3 years shorter than the Index, offset the above factors as rates generally declined by 25 to 45 basis points beyond one year in maturity.

Aside from sluggish employment data, fiscal and monetary stimulus coupled with dollar weakness should favor a short duration due to the likelihood of rising interest rates. Credit exposure was limited to auto and credit card asset-backed, short CMOs and seasoned 15-year mortgage issues; corporate exposure was limited to high quality financials.

### **RCT INTERMEDIATE DIVERSIFIED BOND FUND**

The Fund rose 1.88% for Class A Shares (1.92% for Class B) trailing the

2.65% return of the Lehman Aggregate Index. Detracting from results was a duration nearly one year shorter than the Lehman Aggregate benchmark, as interest rates declined 40 basis points on ten-year Treasuries. An overweight in BBB-rated corporates reduced performance, as lower quality interest rate spreads widened. Finally, the barbelled portfolio positioning hindered results as the yield curve steepened, from 5 years to 30 years, by 17 basis points.

The portfolio yields 40 basis points less than the benchmark, primarily a result of the significant barbelled yield curve structure, but also reflecting a more conservative stance on stable, lower yielding mortgage holdings.

The portfolio is defensively positioned to minimize exposure to short to intermediate maturities, where prices will move most adversely when short interest rates begin to rise. Yields in this maturity range are artificially low due to Fed policy and to leveraged carry trades; it is also a favored area for foreign central bank investment. The Fund’s defensive theme continues in regard to bond market volatility exposure and credit spread widening risk. While this strategy costs the portfolio incremental yield, it can capture significant relative return if bond market conditions worsen, and the highly liquid portfolio can be reallocated into opportunities as they develop. The Fund sub-advisers view their current role as that of preserving capital rather than stretching for return.

## *CUIT Funds*

### **CUIT BALANCED FUND**

The CUIT Balanced Fund returned 3.52%, well ahead of the 3.33% return of the 60% S&P 500/ 40% Lehman Aggregate benchmark. On the strength of its value stock emphasis and good stock selection, the Fund’s

equity portfolio substantially outperformed the S&P 500. Additionally, defense and healthcare issues excluded by CBIS Principled Purchasing guidelines were noticeably weak this quarter; substitution by the Fund into better performing issues added to results.

Stock selection was strong in several sectors, especially within the relatively weak technology sector. Motorola, up 26%, and Avaya, up 22.7%, contributed to performance. A standout among telecommunications issues was AT&T Wireless, which rose over 70% as the firm was auctioned in a competitive bidding process. In the financial sector, which represents 21% of the S&P 500, strong stock choices included Capital One, up 23% on an improving outlook for its credit card business, and Bank One, which gained 21% as a potential merger candidate following the Bank of America acquisition of Fleet Bank during the quarter.

The bond portion of the fund trailed the Lehman Aggregate Index, due in part to a shorter duration as interest rates declined by 40 basis points, and to a lower portfolio yield resulting from the barbelled portfolio structure.

#### **CUIT VALUE EQUITY FUND**

The Fund produced an extremely strong relative result this quarter, returning 5.75% for Class A Shares (5.84% Class B) vs. 3.02% for the Russell 1000 Value Index, resulting from a combination of strong stock selection and an emphasis on the mid capitalization portion of the market. This resulted both from manager preference for relative values among issues ranging from \$1.5 to \$10 billion in capitalization, as well as from underweighting the mega cap portion of the Index.

The Fund held an underweight in financials, the strongest sector (+5.5%) within the Russell 1000 Value

Index during the quarter. Nevertheless, stock selection within financials, in names such as IndyMac Bancorp (+ 22.8%), and Bank One (+ 21%), was quite positive. Stock selection was strong in most sectors; standouts included AT&T Wireless (+70%), the object of auction bidding, Sony (+21%) and McDonalds (+15%) in the consumer discretionary sector, and Motorola (+26%).

The Fund's sub-advisers are concerned about current valuations in the equity market, believing that the outlook for sustained economic growth is already priced into stocks. There has been a shift toward the more stable utilities sector (additions such as First Energy and Duke Energy), as well as use of more reasonably valued ADRS such as Royal Dutch Petroleum, Honda and Scottish Power.

#### **CUIT CORE EQUITY INDEX FUND**

The Fund outperformed the S&P 500 Index during the quarter by a considerable margin; the Class A shares returned 2.2% (Class B shares, 2.19%) compared to a 1.7% return for the Index.

Outperformance resulted from substitution of better performing healthcare companies for excluded pharmaceutical companies, as well from as weak results by some of the defense contractors excluded by Principled Purchasing. While the S&P 500 healthcare sector fell 0.55% this quarter, the companies excluded from the Fund by Principled Purchasing declined considerably more, such as Johnson & Johnson (-1.39%), Bristol Myers Squibb (-14.3%) and Tenet Healthcare (-30.5%). Among the restricted aerospace and defense segment, United Technologies fell 8.6% for the quarter, and Boeing fell 2.17%.

Tobacco was the only excluded category with consistently positive returns, benefiting from its defensive characteristics as part of the consumer staples group.

#### **CUIT GROWTH FUND**

The Fund outpaced the Russell 1000 Growth Index this quarter, with the Class A shares returning 1.46% (Class B, 1.54%) compared to a 0.78% return for the Index. The Fund benefited from lower exposure to the weak industrials and healthcare sectors, but most importantly, from the strength of the Fund's positive earnings surprise and momentum discipline, a favored trend within the equity market early in 2004. Good stock selection in healthcare also helped results, with Caremark Inc. (a leading mail-order drug company) up 31%, St. Jude up 17% on news that a research study showed benefits from the company's implantable defibrillators, and Boston Scientific, up 15% on the combination of good earnings and news of a new stent product.

Performance also benefitted from strong stock selection and an overweight position in financials, with Capital One (a leading provider of credit cards) up 23% as the improving economy reduced delinquencies in its consumer credit card portfolio, and J.P. Morgan Chase up 15%. Stock selection in consumer staples and industrials was also beneficial, as was an overweight position in the energy sector, with Baker Hughes up 13% and BJ Services up 20%.

The information technology sector of the portfolio limited Fund outperformance, as stock selection in this poorly performing sector was weak. Veritas Software, a storage software firm, declined 28% as the company guided analysts' first quarter revenue estimates downward. Intel, after rising 100% during 2003, declined 15% due to profit taking, and as the company guided downward first quarter earnings per share estimates.

The Fund's sub-advisers have had their portfolios positioned for a stronger economy and improving earnings estimates. However, as mortgage refinancing and tax rebates wane, economic growth may well

slow, led by business spending rather than by consumer spending. When the Fed raises interest rates, investors are likely to rotate from consumer and financial issues into more stable growth issues, and the sub-advisers are now shifting the portfolios in anticipation, by moving from consumer discretionary into staples, for example.

### CUIT SMALL CAPITALIZATION EQUITY FUND

The Fund lagged the Russell 2000 benchmark this quarter, producing a 3.86% return for Class A Shares (Class B, 3.98%) compared to a 6.16% return for the Index. The shortfall is primarily attributable to the Fund's underweight in the interest rate sensitive sectors — financials (including REITs) and utilities — which comprise 24% of the benchmark. REITs continued the strong pace evident last year, surging over 10% on investors' demand for yield despite the sector's clear overvaluation. Financial holdings have been reduced this quarter based on their relatively high valuations and the sub-advisers' expectations of rising interest rates.

Emphasis on the economically cyclical basic materials, technology and industrials sectors was not rewarded as in prior quarters, although results benefited from an overweight and good stock selection within the consumer discretionary sector, particularly manufactured homes company Champion Enterprises, which rose 51.4%. Within technology, some of last year's best performers suffered from profit taking, including hard drive manufacturer Maxtor, down 26.6%, and Cray computers, down 33.2% on

news of a delayed government contract. Prospects for each company remain favorable due to improved pricing and tight inventory control.

Stock selection in healthcare was very strong, led by issues such as Sepracor, up 101% on FDA approval of an insomnia drug, and Tularik, an innovative genetic research firm purchased by Amgen this quarter, up 52.3%.

Energy sector exposure was increased during the first quarter, particularly in the oil service area, as increased expenditures for production and exploration will allow further acceleration of profit potential. Healthcare exposure has been expanded with the purchase of new biotech names such as Axonyx, which produces central nervous system drugs, and Nektar Therapeutics, which develops technologies to improve drug performance. Low REIT and financial sector exposure, which had so negatively impacted the fund through March, had begun to reverse course during April on a significant price decline in REITs valuation due to higher inflation data and the resultant strengthening of market expectations of rising interest rates.

### CUIT INTERNATIONAL EQUITY FUND

The Fund trailed the MSCI EAFE Index this quarter, returning 2.33% for Class A Shares (Class B, 2.44%) vs. 4.41% for the Index. The portfolio was substantially underweight Japan, the strongest major developed stock market, particularly its large banks, which were up 31.3% for the quarter. Our managers have preferred European and Australian banks on the basis of their valuations and sustainable earnings; Japanese banks

continue to suffer from declining loan demand, although the recent strength of Japanese equities has helped the banks' balance sheets.

As smaller cap stocks continued to lead larger issues, the Fund's larger cap emphasis detracted, particularly among issues under \$5 billion in market cap. EAFE issues under \$5 billion rose 10% to 11% for the quarter, compared to the 2% gain by EAFE issues above \$20 billion (which represent over one-half of the Index).

An emphasis on the healthcare sector, particularly European companies such as Sanofi Synthelabo and AstraZeneca, detracted from relative results. CBIS' Principled Purchasing guidelines had a modestly positive impact, however, as two large exclusions, Novartis and Roche, were particularly weak.

The top performing EAFE sector this quarter was information technology, followed by industrials and utilities; an emphasis on semiconductors hurt stock selection within technology, while the portfolio was underweight industrials and utilities.

Positive contributors to performance included modest emerging market exposure, with names such as Samsung, America Movil and Yukos up from 33% to 43%. A number of Japanese holdings were strong performers on strong overseas buying, including Sony (+20.9%), Mitsubishi Estate (+43.4%) and Orix (+34.1%).

The Fund maintains a focus on reasonably priced, higher quality global leaders with a record of sustainable earnings, particularly in the healthcare and consumer staples sectors. The Fund has boosted exposure to domestic Japanese retail and financial companies, a broadening from the prior year's focus on exporters. ■

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## ANNOUNCEMENT

### ■ Participant Conference Call: Wednesday, June 9, 2004 at 2:00 P.M.

CBIS Participants are cordially invited to participate in the CBIS Conference Call: Review of CBIS' Investment Manager Selection, Monitoring, and Evaluation Process, which will be held on Wednesday June 9, 2004 at 2:00 P.M. ET. The 20 minute presentation will be followed by an open question and answer period. To submit questions prior to the call, please email your question to: [confcall@cbisonline.com](mailto:confcall@cbisonline.com). Your emailed questions will be answered anonymously during the call. In order to participate, you must register for the call. To register online, please go to [www.cbisonline.com/confcallreg](http://www.cbisonline.com/confcallreg). To register by phone, please call (800) 592-8890 and ask to speak with Todd Patrick (ext. 124). The PowerPoint presentation used in the call will be posted to the CBIS website, and emailed to you on or before June 9th. When you register for the call, please supply us with your email address.

## Contacting CBIS

Can we help you? Please feel free to contact your CBIS representative or Don Platner, Vice President, at 1-800-592-8890 x 115 or Email: [platner@cbisonline.com](mailto:platner@cbisonline.com)

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