CBIS
Christian Brothers Investment Services

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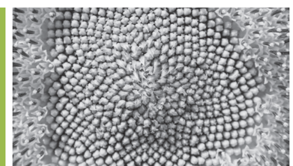
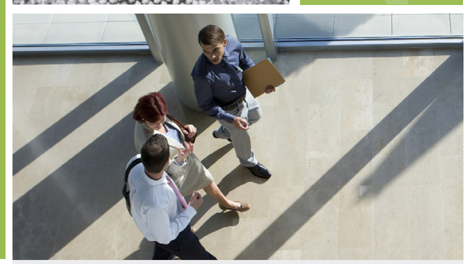
Fixed-Income Investing with CBIS

Summary

Despite the uncertain outlook for interest rates, bonds continue to play a crucial role in portfolio construction. CBIS' institutional fixed-income funds can be used to manage short- and long-term assets, offset equity market weakness, and address the risks of both deflation and inflation.



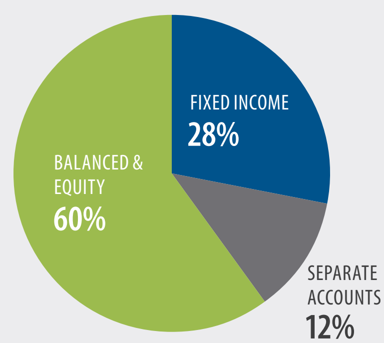
Catholic Responsible Investing



Experience, Expertise, Insight, Knowledge and strong long-term performance are qualities investors naturally seek in an institutional investment manager. These are especially paramount for successful bond investing, where modest but predictable returns can be severely eroded by ill-considered investment strategies and poor credit analysis. The margin for error is low, yet the benefits provided to a portfolio by successful approaches are great indeed.

For more than thirty years, CBIS has administered successful bond programs that help Catholic institutions achieve fund-specific and portfolio-wide investment objectives, achieving highly competitive returns relative to industry standard peer groups and benchmarks while conforming to CBIS' industry leading Catholic responsible investing criteria.

CBIS ASSET REVIEW: BY STYLE



Approximately 1/3 of CBIS assets under management are focused on fixed income investing (as of 3/31/14).

In fact, CBIS pioneered Catholic responsible fixed-income investing using a manager-of-managers structure in 1983 with the launch of the **CUIT Balanced Fund**. In 1985, we created a short-duration bond program, the **CUIT Short Bond Fund**, and in 1995 we launched a longer-duration program, the **CUIT Intermediate Diversified Bond Fund**. In May of this year, we created the **CUIT Opportunistic Bond Fund**, incorporating flexible strategies that can respond to the risk of rising and volatile interest rates and the opportunities created by today's reduced bond market liquidity.

THE ROLE OF BONDS IN AN INSTITUTIONAL PORTFOLIO

Despite strong returns over a 30-year bull market dating to the early 1980s (as depicted in Chart I), high-quality bonds continue to play a crucial role in portfolio construction by offering stable income, low correlation with equities and other risk assets, a hedge on deflation and an offset to weak equity returns. While deflation risk may appear to be low given the Fed's commitment to zero short-term rates and quantitative easing, the U.S. economy remains in the early stages of a long process of deleveraging, with banks reluctant to lend and consumers still heavily indebted. The Fed's ability to provoke more borrowing and growth cannot be taken as a given. As shown in Chart II, in an economic backdrop somewhat analogous to that of today, long-term corporate bond yields fell below today's level in 1934 and declined for 12 more years, reaching 2.5% in 1946. A review of high-quality bond yields back to the 19th century shows they generally remained under 3% from 1872 until World War I. Conversely, given the historically unprecedented magnitude of the Fed's easing since the financial crisis and the growth of its balance sheet, the prospect of eventual inflation with rising rates is a risk investors should consider when positioning fixed-income exposure.

We cannot know the future course of interest rates. We can only prudently prepare for a range of outcomes. CBIS advises institutions not to attempt to forecast the direction of interest rate changes. Our selection of bond funds offer tools to manage the risks of both deflation and inflation.

FIXED-INCOME INVESTMENT PHILOSOPHY

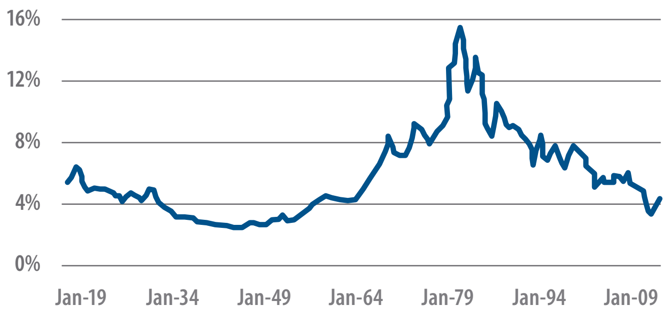
As a manager of managers, CBIS identifies and hires best-in-class managers to execute the desired investment style. We combine two or more managers with unique and complementary approaches in most actively managed funds to augment diversification, and we monitor and evaluate manager performance over time.

Our approach to bond manager selection is based on the belief the bond market is structurally inefficient in ways that equity markets are not, and that these inefficiencies can be captured by skilled managers to generate excess return. While equity investors target some combination of capital gains and dividends, bond investors pursue a wider variety of investment objectives. Insurance companies focus on statutory yields and liability matching, banks on interest rate spreads, mutual funds on high nominal yields, and institutional investors such as CBIS on total return. Investors' self-imposed constraints and restrictions differ by credit quality, liquidity and maturity. Illiquid bonds, for example, may be appropriate for an insurance company but not for a retail bond fund. Moreover, there is a wider variety of security structures offered to bond investors, such as securitized debt, bonds with embedded put and call options (the put option embedded in mortgage securities is a particularly visible example) as well as convertible bonds. These differing goals, constraints and variety of security structures create valuation inefficiencies skilled managers can capture.

While global bond allocations are gaining some degree of promotion within the investment industry, our funds emphasize U.S. dollar-denominated securities for several reasons: Most U.S.-based CBIS participants have U.S. dollar based expenses, dollar-based future liabilities and dollar-based longer-term spending goals. We don't think it makes sense to look overseas for opportunities that exist here at home in dollar-based companies and securities. Bond re-turns are also driven by a much smaller set of factors than are equity returns and there is less advantage in diversifying internationally. Bonds do not offer the potentially unlimited upside that successful equities offer, where a national domicile

I. INTEREST RATES OVER THE LONG RUN

Moody's Aaa Long-Term Corporate Bond Yields (1/1919 – 7/2013)



Source: St. Louis Fed (FRED)

II. DEPRESSION-ERA YIELDS: HOW LOW IS LOW?

Moody's Aaa Long-Term Corporate Bond Yields (7/1929 – 7/1959)

Source: St. Louis Fed (FRED)

and regional presence might be integral to taking advantage of an investment thesis. Finally, there has been a general broad yield convergence in recent years across developed market bonds, which are now relatively homogenous regardless of the domicile of the issuer. This results in little compensation for the associated currency risk, which is generally unrewarded over long periods of time. We prefer that bond mangers focus on bond analysis, not currency risk management. We will take currency risk on the equity side of the portfolio where potential returns are far higher.

SUB-ADVISER FIRM CHARACTERISTICS

CBIS expects our bond sub-advisers to be able to take advantage of opportunities created by the bond market's structural inefficiencies and the variety of available security types. As a result, we favor smaller bond firms, generally those with $5 billion to about $75 billion in assets under management — enough to attract skilled employees while allowing for clear distinction between portfolio management and administrative/operational functions.

Smaller firms can buy and sell without disrupting the market. Larger firms often have reduced ability to actively trade issues within the corporate or municipal sectors, for example, and tend to rely increasingly on derivatives to make tactical moves. They lose ability to capture opportunities associated with smaller position sizes, particularly with the reduced liquidity the bond market has witnessed since the 2008/2009 financial crisis, with fewer dealers and tighter internal risk controls at remaining dealers.

We prefer veteran bond principals and investment teams whose experience spans decades. The resulting depth of knowledge proves invaluable in times such as the 2008/2009 financial crisis, when experienced firms avoided most of the pitfalls of subprime mortgage-backed security (MBS) debt, complex collateralized debt obligation (CDO) structures and credit default swap (CDS) positions. General characteristics we emphasize when choosing our managers include:

- Experienced investment teams who've worked together for years or decades
- An exclusive focus on bonds or an emphasis on bonds as a core aspect of the business
- Independent and employee-owned or managerially independent from corporate owners
- Demonstrable skill at credit analysis
- Lack of significant staff turnover
- Evidence that financial incentives are properly aligned with those of investors like us
- Demonstrated ability to retain and incentivize key staff

III. CBIS INSTITUTIONAL FIXED INCOME FUNDS

	CUIT MONEY MARKET	CUIT SHORT BOND	CUIT OPPORTUNISTIC BOND	CUIT INTERMEDIATE DIVERS. BOND
Manager (% Assets)	Wellington (100%)	Longfellow (100%)	Longfellow (50%) Reams (50%)	Dodge & Cox (20%) Jennison Associates (40%) Reams Asset Mgmt. (40%)
Benchmark	ML 91-Day Treasury Bill Index	BofA/ML 1-3 Year Treasury Index	Barclays 1-5 Year Government Credit Index	Barclays Capital Aggregate Index
Investments	■ Short-term U.S. dollar-denominated money market instruments such as U.S. Treasury bills and notes, asset-backed securities, and commercial paper and certificates of deposit primarily rated A-1/P-1 or higher. ■ Average portfolio maturity is 90 days or less	■ Short-term U.S. government, agency, corporate, asset-backed and mortgage-backed securities ■ Up to 10% of the portfolio may be invested in short-maturity bonds rated below-investment-grade	■ Primarily U.S. government, agency, corporate, mortgage- and asset-backed securities (below-BBB permitted up to 20% of total Fund assets) ■ Opportunistic but modest use of derivatives to employ credit spread strategies and duration exposure at reduced trading costs ■ Opportunistic but modest use of merger-arbitrage (announced mergers only with no leverage)	■ U.S. Government, agency, corporate, mortgage-backed and asset-backed securities with an effective duration of 4 to 6 years ■ Holdings are primarily investment grade (BBB to AAA, based on the three primary agency ratings), with no more than 10% of the portfolio rated below BBB.
Duration Range	Seeks to maintain stable $1/share net asset value	Approximately 1.5 years	Approximately 1 to 4 years	Approximately 4 to 6 years
Portfolio Applications	■ Cash management ■ Principal protection ■ Income (dependent on the level of cash market yields)	■ Yield enhancement for cash not requiring immediate liquidity. ■ Income (dependent on the level of short-term yields) ■ Principal protection	■ Hedge against equity market weakness ■ Source of stable income ■ Helps bond exposure contend with volatile and generally rising interest rates	■ Deflation hedge ■ Portfolio hedge against equity market weakness ■ Source of stable income
Inception Date	January 1985	January 1985	May 2013	January 1995

ALL CBIS INSTITUTIONAL FUNDS ARE MANAGED IN ACCORDANCE WITH CBIS' INDUSTRY-LEADING CATHOLIC RESPONSIBLE INVESTING CRITERIA

CBIS expects our bond sub-advisers to be able to take advantage of opportunities created by the bond market's structural inefficiencies and the variety of available security types.

INVESTMENT STRATEGY

Successful bond managers generally avoid attempting to predict the direction of interest rate changes. Those who try this approach are nearly always unsuccessful and their demise helps create the "survivor bias" evident in historical manager returns. CBIS' bond managers typically constrain duration within a reasonable range of their benchmark's duration, and seek to create excess return through effective credit analysis and active trading, taking advantage of structural market inefficiencies and individual issue valuation opportunities. CBIS' bond managers emphasize achievement of value-added through a combination of:

- Sector exposures
- Yield curve positioning
- Modest range of duration exposure versus the benchmark
- Issue selection

We prefer firms which emphasize qualitative analysis while avoiding too-heavy reliance on quantitative modeling. Quantitative specialists often lack long-term experience and informed perspectives on how mathematical models can be thwarted by risks such as liquidity risk and basis risk. In our view, managers who lack experience over several market cycles may not fully understand the risks they are taking.

FUND STRUCTURES AND COMPLEMENTARY INVESTMENT STYLES

CBIS' bond funds are designed to offer stable income flows (commensurate with duration), low correlation with equities and other risk assets, and portfolio holdings that emphasize high-quality securities (with selective, modest use of lower-quality debt subject to manager expertise and discretion). When asset levels permit, we combine two or more complementary investment styles in a fund to promote enhanced diversification beyond that provided by sector and issues diversification alone.

CUIT MONEY MARKET FUND

Our money market fund emphasizes intensive in-house credit analysis, value-driven sector rotation, issue selection and avoidance of credit downgrades and default-related losses. The Fund does not seek to project interest rate moves and hedges duration in a rising interest rate environment.

CUIT SHORT BOND FUND

Designed to offer income with stability of principal, the Fund seeks excess return with controlled risk by emphasizing sector rotation and security selection rather than interest rate anticipation and duration positioning. The portfolio is fully invested, structured to provide a yield premium to the market, and seeks excess return in all market environments and at all stages of the credit cycle.

CUIT OPPORTUNISTIC BOND FUND

The Fund is structured to give its sub-advisers the duration and strategy flexibility needed to contend with volatile and generally rising interest rates and with reduced bond market liquidity.

Longfellow Investment Management applies a fundamental, bottom-up approach that seeks to capitalize on bond market inefficiencies. Primary objectives are to preserve capital, minimize volatility and earn attractive risk-adjusted returns. A sub-component of its strategy seeks to capture the "arbitrage spread" in announced mergers, i.e. the difference between the price of the securities being acquired and the price offered by the acquiring company.

Reams Asset Management employs both macroeconomic and bottom-up strategies to uncover value and react opportunistically to valuation discrepancies and volatility opportunities. The firm closely evaluates the relation between current and historical real interest rates in determining duration positioning. When real rates are above historical norms, the bias will be to longer duration and vice-versa. The approach emphasizes long-term value and total return.

CUIT INTERMEDIATE DIVERSIFIED BOND FUND

The Fund is structured to provide stable income, a deflation hedge and a hedge on equity market weakness. The Fund combines three complementary investment styles.

Dodge & Cox applies intense fundamental research to identify improving credits in the higher-yielding sectors of the investment-grade market that offer an income advantage over the benchmark and potential capital gains. Portfolio turnover is relatively low.

Jennison Associates strategy is founded on the belief that yield spreads, yield curve shape and prices of individual issues revert to the mean over time. Jennison seeks to add value from a combination of issue selection, yield curve positioning, sector rotation and active trading, while remaining duration-neutral.

Reams Asset Management combines top-down duration and yield-curve strategies with bottom-up security selection. It seeks to capture valuation discrepancies created by bond market volatility, emphasizing long-term value and total return.

PORTFOLIO APPLICATIONS

CBIS utilizes all fixed-income strategies when developing diversified portfolios that match participants' cash flow needs and risk tolerances with investment goals. Yet we can make a few brief generalizations about how specific funds are used within a broader portfolio.

- Operational assets are typically held in the **CUIT Money Market Fund**
- Operational assets in excess of the amount needed over the next year, along with "rainy day" funds and patrimony accounts, are often invested in the **CUIT Short Bond Fund**. The short time to maturity of Fund holdings means there is a lower sensitivity of principal value to rising rates than is the case with longer-maturity bond funds. The Fund's yield provides income with low volatility, making it a good investment for excess cash.
- For assets with a planned average life of three years or more, a custom blend of the Short Bond, **CUIT Opportunistic Bond** and **CUIT Intermediate Diversified Bond Fund** can be combined with equity exposure. Factors that determine the exact combination include timing of expected cash flows, financial sophistication of the participant, degree of uncertainty regarding cash inflows, comfort level with volatility of returns and asset levels, and the timing of the targeted investment horizon.