Why Multi-Style US Equity?

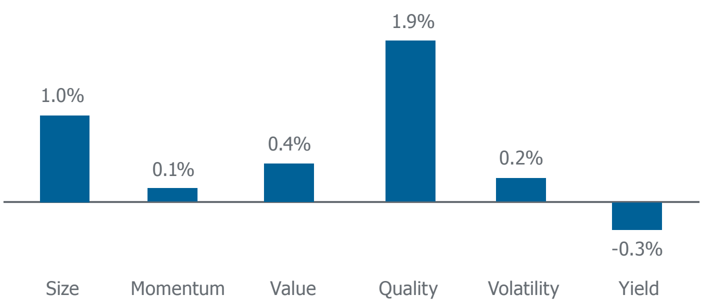
CBIS CATHOLIC RESPONSIBLE INVESTMENTS℠ SEPTEMBER 2020

The equity portion of an investor's portfolio typically serves to drive long-term total return above what could be achieved by investing in bonds and money market investments alone. Making wise choices from among the many thousands of available equity investments further improves an investor's potential for higher total returns.

Research shows there are specific factors associated with higher equity returns. These factors – value, size, momentum, low volatility, profitability and others – are increasingly investable, enabling a departure from the "style-box" method of investing popularized in the 1990s. Active management incorporating these return drivers have been shown to provide potential for enhanced returns, particularly for portfolios characterized by long holding periods (see Exhibit A).

This paper seeks to illustrate how strategic exposure to these return drivers conducted by high active-share portfolio managers may serve to improve investor's potential to achieve attractive risk and return targets.

EXHIBIT A
Excess Returns by Factor
(15 Yr. Ann.)



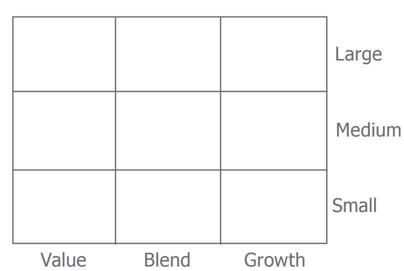
Source: Russell

MOVING OUTSIDE THE TRADITIONAL STYLE BOX

Since the early 1990s, when the ratings organization Morningstar popularized the style box, investors have tended to define their equity options by value and growth style and by market capitalization segments (see Exhibit B). The investment management and consulting community had a similar approach, categorizing equity strategies into universes that echoed the Morningstar style box. Managers were expected to stay within these style boxes on a consistent basis and those whose investment styles didn't conform were often left out of searches. The latest research suggests investor returns might have been better by including these out-of-the-box strategies.

Style boxes can impose somewhat arbitrary constraints on a manager's ability to implement investment strategy. According to a study by Russ Wermers, professor of finance at the University of Maryland (Wermers, 2002), managers with the best stock picking skill often implement strategies that involve a significant amount of style drift or movement outside the style box. Thomas Howard, a finance professor at the University of Denver (Howard, 2010), posits that it is more important for a manager to adhere to a narrowly defined strategy, than to a style box. His thesis holds that stocks that fit within a manager's strategy will respond to evolving economic and market conditions and will move in and out of market capitalization ranges, sectors, and styles. This fits with our view at CBIS of hiring managers based on core competencies, rather than for distinct growth or value styles.

EXHIBIT B
Morningstar Style Box™



Source: Morningstar

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BEYOND GROWTH AND VALUE

Under style box theory, investors have been advised to maintain separate growth and value exposures within their overall portfolio to achieve a diversified mix. This approach has worked reasonably well but with results that may have been suboptimal. As more data have become available and research techniques have become more sophisticated, attention has focused on the question of what truly drives equity returns. The resulting research has shown that conventional style box investing does not necessarily translate to the best way to generate alpha. Factors other than growth and value style tend to be responsible for the differences in outcomes.

As they are currently constructed, style boxes basically only consider a stock's size or price/earnings metric. This narrow view tends to offer more insight into cyclical return differences than to the drivers of long-term returns. A study by the investment consulting firm Mercer (Mercer, 2014), found that exposure to certain factors – value, size, momentum, low volatility, and profitability (see Exhibits in Appendix) – can be expected to contribute to portfolio outperformance over the long run. The study concluded that investors should include a positive bias to these factors. This view, that there are many drivers of equity returns, is not unique to Mercer as there is a large body of academic work on which Mercer's study is built. The Russell Factor Indexes, represented in the chart on the first page of this paper and in the table below are designed to track the effects of size, momentum, value, quality, volatility and yield on equity returns. The table below shows the performance of these different return drivers within the Russell 1000 benchmark since 2010. Growth factors are not explicitly shown as managers that label themselves as growth tend to have either underlying quality or momentum factors as their return drivers. The key takeaway is that multiple factors can drive equity returns and the performance of these drivers can vary from year to year.

This research continues to provide evidence in support of the efficacy of a multi-style approach to equity investing.

Relative Annual Performance of US Equity Factors 2010 – 2019

2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Size 27.8%	Yld 11.1%	Size 19.2%	Size 36.6%	Vol 15.9%	Vol 3.1%	Val 18.7%	Qual 28.1%	Vol -2.4%	Qual 32.2%
Val 20.1%	Vol 8.5%	Val 18.8%	Val 36.4%	Yld 14.0%	Mom 2.7%	Yld 17.4%	Mom 22.8%	Qual -2.7%	Vol 32.2%
Yld 17.3%	Qual 8.5%	Qual 16.1%	Mom 33.6%	Qual 13.3%	Qual 2.1%	Size 16.0%	Vol 20.0%	Mom -4.4%	Mom 30.9%
Mom 17.1%	Mom 2.3%	Mom 15.5%	Qual 31.7%	Val 12.9%	Yld 0.0%	Vol 11.6%	Val 19.7%	Yld -4.9%	Val 29.8%
Qual 14.5%	Val 1.8%	Vol 13.3%	Vol 29.6%	Mom 12.7%	Size -2.3%	Qual 10.7%	Size 18.3%	Val -8.1%	Size 29.0%
Vol 11.8%	Size -1.2%	Yld 11.8%	Yld 28.6%	Size 11.3%	Val -3.3%	Mom 7.9%	Yld 16.0%	Size -8.3%	Yld 25.4%
Russell 1000 Index									
16.1%	1.5%	16.4%	33.1%	13.2%	0.9%	12.1%	21.7%	-4.8%	31.4%

Source: Russell

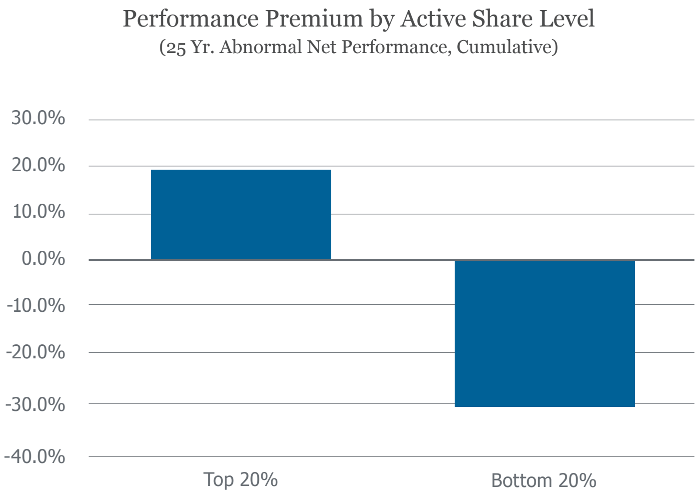
The table shows the returns for the following Russell 1000 indexes: Momentum Factor Index, Quality Factor Index, Size Factor Index, Value Factor Index, Volatility Factor Index, Yield Factor Index. Descriptions of the indexes can be found in the Appendix.

Why Multi-Style US Equity?

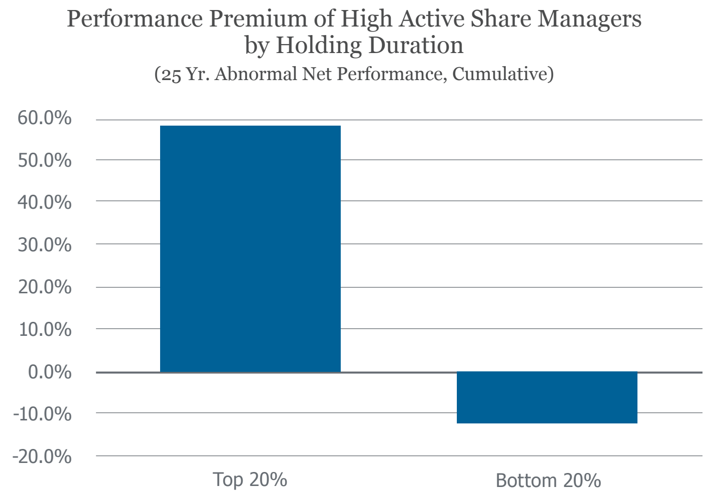
HIGH-CONVICTION ACTIVE MANAGEMENT

Empirical studies show that effective active management can serve to broaden the potential performance benefits of strategies designed to harness return drivers. Although some managers offer passive vehicles with factor exposure, we see potential to better capture the return driver benefits through active management. We believe highly skilled managers can add value above the factor index and we find it advantageous that managers can provide exposure to one or multiple factors within their investment approaches. In a 2009 study, managers demonstrating a high level of active share – a measure of how much the manager's portfolio differs from the benchmark – were shown to outperform their benchmarks both before and after expenses, while those managers with the lowest active share have underperformed after expenses (Cremers & Petajisto, 2009). In this study, illustrated in the chart below, left, researchers Martijn Cremers and Antti Petajisto found that high active share does not necessarily equate to high risk, as measured by tracking error or standard deviation of returns.

In addition, Cremers found, in a follow-up paper, that high active share managers with longer holding periods tended to outperform those with shorter investment horizons (Cremers M., 2016). This is illustrated in the chart below, right. According to Cremers, high active share managers can expect to have the most success if they also employ approaches that are more difficult to implement, such as those that require conviction over the long-term.



Source: Cremers & Petajisto, 2009



Source: Cremers M., 2016

CONCLUSION

Current research supports a multi-style approach to equity investing conducted by high conviction active managers with long-term focus. CBIS intends to provide Catholic institutional investors access to this approach, in a manner consistent with Catholic values, through both the CUIT Magnus® Funds and a stand-alone CUIT Fund option.

We anticipate the CUIT Multi-Style US Equity Fund will launch in winter 2020/2021 and we have selected high conviction active managers to provide stewardship of its investment capital. With demonstrated exposure to different expected return drivers and little overlap in their holdings, we are confident these managers will combine to provide diversification and attractive outcomes.

Why Multi-Style US Equity?

CATHOLIC RESPONSIBLE INVESTMENTS[SM]

Since 1981, CBIS has provided Catholic institutional investors with access to multi-manager investment strategies. We seek to anticipate the evolving needs of this distinct group of investors and deliver tailored investment solutions. The launch last year of the CUIT International Small Cap Equity Fund serves as one example.

We believe our strength lies in combining highly skilled, complementary managers to implement an active investment strategy. In doing so, CBIS considers the persistence of each manager's outperformance relative to a desired benchmark, risk mitigation strategies, the quality of the investment team and the robustness of support systems, among others.

Our investment philosophy holds that successful long-term investment managers possess core competencies that drive decision-making. This approach requires conviction to withstand short-term underperformance. It establishes diversification across core competencies and helps manage portfolio risk.

APPENDIX

Key Drivers to Consider in Building an Equity Portfolio

Driver	What is it?	Rationale
Value	Bias towards cheap stocks on a measure of value such as price to book or price to earnings	Return enhancing due to (a) behavioural overextrapolation of earnings growth, (b) "distress" risk premium, and (c) the rebalancing effect
Size	Bias towards companies with a smaller market capitalisation	Return enhancing due to (a) small company illiquidity and credit risk premia and (b) the rebalancing effect of selling stocks that have risen in price
Momentum	Bias towards stocks that have recently performed well	Return enhancing due to behavioural factors of (a) underreaction to company news, (b) overreaction to recent stock price performance, and (c) herding
Low Volatility	Bias towards stocks with historically low absolute variability of returns	Risk-adjusted return enhancement due to (a) lottery effect whereby high-volatility stocks are systematically overpriced, (b) leverage aversion, and (c) tracking error constraints causing systematic overpricing of high-volatility stocks (as not owning these disproportionately increases tracking error)
Profitability	Bias towards stocks with a strong measure of profitability, such as return on equity	Return enhancing due to behavioural underestimation of the long-term sustainability of high-quality businesses

Source: Mercer, 2014

Why Multi-Style US Equity?

APPENDIX (CONTINUED)

Factor Premia and Definitions

Factor		Description	Definition
Quality	Size	**The Quality Premium:** Higher quality companies tend to demonstrate higher performance than lower quality companies. **Quality Tilts:** Can help capture companies with the ability to consistently generate strong future cash flows, while limiting exposures to stocks that are unprofitable or highly leveraged.	Composite of profitability, efficiency, earnings quality and leverage.
Value	Momentum		
Volatility			

Factor		Description	Definition
Quality	Size	**The Size Premium:** Smaller companies tend to demonstrate higher performance than larger companies. **Size Tilts:** Can help capture excess returns of smaller companies relative to their larger counterparts.	Log of full market cap.
Value	Momentum		
Volatility			

Factor		Description	Definition
Quality	Size	**The Value Premium:** Stocks that appear cheap tend to perform better than stocks that appear expensive. **Value Tilts:** Can help capture exposures at a reasonable price relative to their fundamentals.	Composite of cash flow, earnings and country relative Sales: Price Ratio.
Value	Momentum		
Volatility			

Factor		Description	Definition
Quality	Size	**The Momentum Premium:** Stock performance tends to persist, either continuing to rise or fall. **Momentum Tilts:** Can lead to the selection of companies with strong recent performance, with the expectation that this will continue to produce short term excess returns in the future.	Cumulative 11 month return.
Value	Momentum		
Volatility			

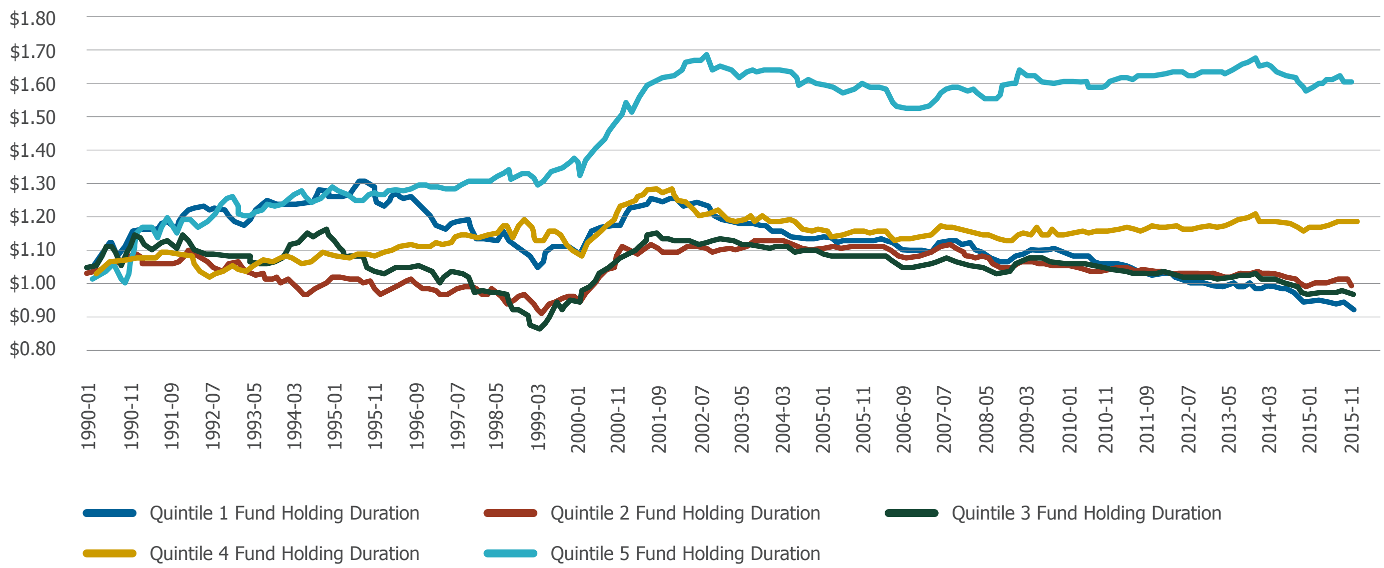
Factor		Description	Definition
Quality	Size	**The Low Volatility Premium:** Stocks that exhibit low volatility tend to perform better than stocks with higher volatility. **Low Volatility Tilts:** Can help capture companies with a historically lower risk (and higher return) profile relative to higher risk counterparts.	Standard deviation of 5 years of weekly local total returns.
Value	Momentum		
Volatility			

Source: FTSE Russell

Why Multi-Style US Equity?

APPENDIX (CONTINUED)

Performance Premium of High Active Share Managers by Holding Duration



Quintile 1 - *Shortest Duration* Quintile 5 - *Longest Duration*

Source: Cremers M., 2016

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CHRISTIAN BROTHERS INVESTMENT SERVICES: SUB-ADVISER OVERVIEW

CUIT Multi-Style US Equity Fund

Catholic Responsible Investments™

WELLINGTON MANAGEMENT®

Objectives

- Performance: Seeks to consistently outperform growth index, and the broad market longer-term
- Risk: Above median tracking error, above market beta
- Portfolio Turnover: 50% - 100% annually

Philosophy

- Competitive forces create significant hurdles for companies to sustain above-average growth for long periods of time
- Companies with high barriers to entry are best positioned to sustain growth and reward shareholders over time
- Investors often underestimate a company's ability to grow
- Market is overly focused on the short term, creating opportunities for timeframe arbitrage

Strategy Name
Opportunistic Growth ex-Small Cap Growth
(customized version of Opportunistic Growth for CBIS)

Inception
1999 (CUIT inception: 2021)

Portfolio Managers
Drew Shilling, Tim Manning

Location of Team
Boston, MA

Firm Ownership
100% Employee Owned

Investment Process

- Goal is to create a portfolio based on three principles: Focus on sustainable growth, identifiable competitive barriers to entry, superior business models
- Investment Approach: Bottom-up stock selection based on rigorous fundamental research and access to corporate decision makers
- Idea Generation
  - Initial universe of all US stocks with market capitalizations corresponding to the Russell Mid Cap Growth/Russell 1000 Growth indices
  - Universe narrowed to about 700 stocks with above-average growth
  - Research to differentiate sustainable growth from short-lived events; candidates for purchase have high/improving return on capital, strong management, quality balance sheet, and sound corporate governance
- Buy Decision: Stocks purchased for the portfolio based on free cash flow generation, upside potential, and team's confidence in forecasts
- Sell Decision: Stocks are sold when better ideas are uncovered or the original thesis is violated
- Portfolio combines best ideas of Growth (large cap) (~85%) and Mid Cap Growth (~15%) portfolios

Portfolio Construction & Risk Management

Portfolio Construction

Market Cap
Typically comparable to benchmark

Sector Weights
Generally within +/- 15 percentage points

Valuation
Typically comparable to benchmark

Growth
Typically comparable to benchmark

Non-US companies
Less than 20% of portfolio

Position size
5% or index weight +2% if greater

Typically 70 – 100 holdings

Cash
Less than 5%

Derivatives
To equitize cash

IPOs
Allowed

Risk Oversight

Portfolio Management
Understand single company risk

Aim to construct portfolio so that individual positions have differentiated and uncorrelated sources of return

ESG considerations

Consider client specific guidelines

Compliance engine and pre-trade analysis

Product Management
Independent portfolio analysis

Style consistency/factor risks/stress testing

Capacity/business risks

Investment and Risk Management
Research and insights on risk and market trends

Risk Advisory Council

Develop new analytics/tools

Line Management and Senior Management review groups
Philosophy/process/performance/characteristics

Resource assessment

Compliance
Active pre- and post-trade compliance monitoring

CUIT Funds: Why Wellington

- Highly skilled team and supported by an experienced dedicated analyst team in addition to the vast resources of Wellington.
- The high conviction growth investing approach has been consistent since inception, supported by a disciplined and sensible process.

CBIS®

CHRISTIAN BROTHERS INVESTMENT SERVICES: SUB-ADVISER OVERVIEW

CUIT Multi-Style US Equity Fund

Catholic Responsible Investments™

DODGE & COX®

Objectives

- Performance: Long-term growth of principle and income
- Risk: Above median tracking error, above market beta
- Portfolio Turnover: approx. 20% annually

Philosophy

- Focus on companies where current market valuation does not adequately reflect the company's long-term profit opportunities
- Research intensive with a rigorous price discipline and long-term focus
- Bottom-up and value-driven

Strategy Name
US Equity

Inception
1965 (CUIT inception: 1991)

Portfolio Managers
Team Managed

Location of Team
San Francisco, CA

Firm Ownership
100% Employee Owned

Investment Process

- Idea Generation
  - Initial universe of all US stocks with market capitalizations greater than $5 billion
  - Universe narrowed using screens on price-to-book, price-to-sales, and price-to-cash flow ratios
  - Fundamental research focuses on evaluating a company's financial staying power, estimating ability to grow earnings and cash flow, and assessing the strength and depth of the management team
  - Three to five-year earnings forecasts are generated to establish valuation for companies under consideration
- Buy Decision: Stocks purchased for the portfolio based on valuation within a confidence range
- Sell Decision: Stocks are sold when stock valuations reflect expectations that do not align with the team's, deterioration in the company's long-term fundamentals, or there are more attractive investment opportunities available

Portfolio Construction & Risk Management

Stock selection is a result of bottom-up analysis

Portfolio holds 60- 90 stocks

No formal sector limitations, industry weights limited to 25%

Up to 20% can be in non-US stocks

CUIT Funds: Why Dodge & Cox

- Dodge & Cox has consistently applied its long-term investment philosophy since inception.
- The intensive research efforts conducted by a deep team of sector-specialist analysts is impressive.
- The firm is stable and well run with a strong culture that attracts the best and brightest.

CBIS®

CHRISTIAN BROTHERS INVESTMENT SERVICES: SUB-ADVISER OVERVIEW

CUIT Multi-Style US Equity Fund

Catholic Responsible Investments™

MAR VISTA INVESTMENT PARTNERS

Objectives

- Performance: Long-term growth of capital
- Risk: Above median tracking error, but lower than market beta
- Portfolio Turnover: 10% -30% annually

Philosophy

- Sustaining excess returns on capital requires durable competitive advantages
- Capital preservation is equally important as appreciation
- Invest in high quality growth businesses trading at discounts to fair value

Strategy Name
Strategic Growth

Inception
2003 (CUIT inception: 2021)

Portfolio Managers
Silas Myers, Brian Massey, Joshua Honeycutt, Jeffrey Prestine

Location of Team
Los Angeles, CA

Firm Ownership
100% Employee Owned

Investment Process

- Collaborative process through a common investment framework to identify quality businesses
- Idea Generation
  - Initial universe of all US stocks >$ 2 billion market cap, narrowed to 150-170 stocks based on in-depth qualitative analysis of industry, value chain, competitive dynamics, secular growth opportunities, and management team
  - Universe is ranked by margin of safety using extensive financial models
- Buy Decision: Businesses with wide economic moats, shareholder value growth, and management teams that allocate capital to the benefit of shareholders. Decision incorporates size and durability of moat, expected growth of intrinsic value, margin of safety, range of potential outcomes, and potential for permanent loss of capital, leading to most attractive 30-50 names
- Portfolio Construction/Risk Management
  - Benchmark aware but may take significant absolute and relative allocations in any particular sector as long expected risk/return tradeoffs are attractive. Sector allocations generally within +/- 15% of index
  - Economic factor exposures reviewed to ensure every decision is intended
  - Cash: Typically 2%-5%, max of 15%
  - Position Size: 1% - 5%
- Sell Decision: Stocks are sold when target prices are reached, better ideas are uncovered, or the original thesis is violated

Portfolio Construction & Risk Management

Portfolio Construction Based on Multiple Factors

- Growth of intrinsic value (serial compounders)
- Durability of competitive advantages
- Margin of safety (Intrinsic Value/Price)
- Range of outcomes favoring limited downside
- Evaluate the potential impact of ESG factors
- Overweight asymmetric investment opportunities
- Assess macroeconomic factor correlations to ensure portfolio diversification

Avoid Traps of Typical Sell Discipline

- Devil's Advocate
- Line in the Sand
- Identify Behavioral Biases

CUIT Funds: Why Mar Vista

- Mar Vista utilizes a sound investment philosophy and process that has been consistent since the team began working together in 2003.
- The common process and strong team dynamic results in effective and efficient decision making.
- Strategy does not fit neatly into a standard industry style box, incorporating elements of quality, growth, and value, which is appealing in a multi-manager fund.

CBIS®