

PRINCIPLES



A Quarterly Newsletter published by Christian Brothers Investment Services, Inc.

Q4 2005

CBIS and CBS: Separate Companies Collaborating in the Same Spirit

Recently, Brother Michael O'Hern FSC, President/CEO of Christian Brothers Investment Services (CBIS), and Brother William Walz FSC, President/CEO of Christian Brothers Services (CBS), reflected on their companies' common foundation, vision and collaboration, as well as their different products and services.

On the Founding of the Two Companies



William: As an entity, Christian Brothers Services was founded in 1985 to take over activities that formerly had been done by the Christian Brothers. The activities go back much farther, probably into the 1960s. Originally, they were simply cooperative purchasing programs for the institutions of the Christian Brothers. As time went on, these began to thrive and include other religious congregations until Christian Brothers Services was founded in 1985. CBS is now a 501 (c)(3) independent company even though the sole member is Christian Brothers Conference.



Michael: CBIS was founded in October of 1981 by Br. Louis DeThomasis and Br. Joel Damien. Br. Damien was instrumental in the beginning of all or most of the programs at both CBIS and CBS. He had been working with Catholic organizations for quite some time. As the needs of these organizations grew, he devised programs to better address these needs. He was

among the first to realize that the needs of Catholic institutions were better met through centralized resources, and that these resources could help to promote sound management practices. That concept was instrumental in founding CBIS.

William: In fact, we state our vision as "the Catholic Church working cooperatively to meet managerial needs cost efficiently, using our experience and leadership as an important resource and motivator." We see our service to the Church as rising from our experience, our expertise, and our leadership in developing cooperative programs. In that way, we serve the Catholic Church community by responding to its managerial needs.

On the Mission and Philosophy of CBIS and CBS

Michael: The mission of CBIS is to collaborate with Catholic institutions to help them achieve their financial goals through the socially responsible management of their investments. Again, this is based on the power of cooperation and coming together. There are a couple of key ways in which this vision plays out for our investment programs. First, by coming together to pool our assets, we can cost-effectively access premier institutional investment talent. Second, we create a greater voice for all

of us in speaking about the issues of concern to the Catholic community. This pooling of assets is critical to the implementation of our mission. Our vision is to define the standard for socially responsible investing for Catholic institutions.

William: The CBS service philosophy mirrors what you are doing through CBIS — most of the programs that we administer are cooperative programs composed of Catholic Church organizations. These programs are what most people describe as belonging to the insurance field: health benefits for employees, a separate form of health benefits for members of religious congregations, a prescription drug program, retirement plans which include a defined benefit plan, as well as 403(b), and 401(k) savings plans, and a prop-

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erty/casualty risk pooling trust. We provide other services that are not primarily cooperative, but they are becoming that way, such as web hosting and design. We also operate a travel agency, and smaller programs like an unemployment reimbursement program and a student accident plan. We excel wherever there is an economy of scale that can be achieved by people coming together in a cooperative.

Michael: We offer a diversified product line of domestic and international equity, fixed-income, and cash management funds with separately managed accounts available in most of those asset classes as well. Our investment advisors work with each participant organization to develop an investment strategy, report on performance, interpret developments in the financial markets, help assess their progress in meeting their financial goals, review socially responsible investment initiatives, and answer any investment related inquiries. In those cases where a participant already works with an investment management consultant, our advisor works with that consultant as well as with the participant.

On CBS and CBIS Participants and the Church

William: It is important to note that participants in the programs we administer are institutions of the Church. To enroll in any of the programs, an institution has to be a 501 (c)(3) organization listed in the Kenedy Official Catholic Directory.

Michael: That's true for us as well. We work with religious institutes; we serve about 20 percent of the Catholic dioceses in the United States. We also work with healthcare and educational institutions, retreat centers, youth care facilities, fraternal organizations and many others, as long as they're listed in the Official Catholic Directory.

William: As an organization of the Church, CBS facilitates the Church

working together to take care of its own needs. We don't see ourselves as a company that sells things to the Church. We are a division of the Church that specializes in working with other organizations within the Church. As we work together cooperatively, we achieve economies of scale to accomplish more than any one of us could accomplish on our own. Plus, we do that cost effectively. CBS administers these programs; we don't own them. The members own the cooperatives and hold their funds. The program trustees hire us to administer their program. The programs are self-funded cooperatives owned by the members.

CBS

“We see our service to the Church as rising from our experience, our expertise, and our leadership in developing cooperative programs. In that way, we serve the Catholic Church community by responding to its managerial needs.”

—Brother William

Michael: That's very similar to how we operate. For the two trusts we administer, the trustees have the responsibility and the ability to select what practices are best and make the most sense for the participants in the trust. We work with our participants to help them understand how aspects of their mission are reflected in the ways their money is invested. Our programs are structured so that an organization's investment program is an integrated part of its mission. The integration of financial management and mission is a primary benefit of working with CBIS.

On the Similarities Between the Two Companies

William: The relationship between our companies can be very confusing for members who belong to the programs we administer. We started from the same beginnings during slightly different time periods. People get confused when they hear the term, “Christian Brothers.” They don't make the distinction between Christian Brothers Services and Christian Brothers Investment Services. We are separate entities. I suppose the best analogy would be to consider ourselves as cousins. We came from the same general origins, but we are separate and we each offer a different family of services. In many ways we are alike and we share similar philosophies. So, we are related in that sense even though we are separate entities.

Michael: You are right. There is a lot of joint goodwill that is built up through name recognition. That has a positive impact when we refer people to one another in order to benefit from the services we offer. I know we have some common participants with whom we both work, but we address different dimensions of their needs: CBS for administration; CBIS for investment of pooled assets. We also extend joint hospitality to many religious institute participants at NATRI. In a very concrete way, it is a reminder that while our organizations were founded, sponsored and owned by Christian Brothers, we have both expanded our mandates significantly. We are now working together for the benefit of the entire Church

William: Yes. Even though all of these programs that both of our companies administer are called the Christian Brother Plans and their origins came from the Brothers, they are not our plans. They are Catholic cooperative plans. Sometimes I find that people think these are the Brothers' plans and everything there belongs to the

Brothers. I think the Holy Spirit has given us a task — a responsibility of service and ministry within the Church. We are servicing the Church in a way that perhaps nobody else within the Church does.

Michael: That's true. Certainly both of our organizations have expanded far beyond the original vision. The unique gift that CBIS brings to the Church is that we concentrate equally on delivering competitive returns and social responsibility in our investment program. The reason we focus equally on these goals is to help Catholic institutional investors comply with the Bishops' mandate on investments as expressed in their pastoral letters. Catholic institutions are particularly conscious of both the fiscal and ethical dimensions of their investment programs. That above all else makes us unique. We have structured our entire socially responsible investment program particularly for and from a Catholic perspective. Our program combines principled purchasing decisions (stock screening) and active ownership (shareholder advocacy) in order to encourage companies to become better, more responsible corporate citizens.

We also consider it our mission to give back to the Catholic community. Every year, we collaborate with our participants by contributing a percentage of our profits to support their educational and social ministries. All participants can apply for those grants. So, they benefit both from their own investment returns and as potential grant recipients from company earnings.

On the Influence of Faith

William: Although what we do on a daily basis imitates a business model, it is a ministry of the Church. Our employees collaborate with each other to provide their time, effort, and talent in a form of ministry. I think that makes us very unique in the worlds in which we all work.

Michael: Our Catholic faith is central to how we operate. In addition to informing our socially responsible investing guidelines, our faith also influences our business decisions as an organization. We deliberately challenge ourselves to model our values and practices on the values and the practices that we ask of the companies in the portfolios of our investment programs. So if we've entered into a dialogue with a company on a specific issue, we ask ourselves how well our own practices stand up on that issue. Ultimately, both our investment policies and our corporate behavior are direct extensions of our Catholic faith.

CBIS

“We work with our participants to help them understand how aspects of their mission are reflected in the ways their money is invested. . . . The integration of financial management and mission is a primary benefit of working with CBIS.”

—Brother Michael

William: All of the programs we administer follow the teaching of the Church, which can be very challenging in some areas. I can think of many times when health care issues put us at odds with society in general. We have a responsibility as a Catholic Church organization providing services for organizations of the Catholic Church to adhere to the teachings of the Church. That can be demanding in the business world. Living our faith as a Catholic organization overrides almost everything we do in terms of the programs that we provide or administer.

Michael: The mission is central to all Catholic organizations, so investing in a way that is consonant with that mission is critical for them. The structure of our investment programs enables them to maintain that focus and extend that mission to include their investment programs. It's not a separate piece; it's an integral part of what they are about as an organization.

William: I agree. Mission is central to what we do at CBS. Our focus on mission makes both of our organizations unique and distinct from the commercial marketplace, but not from each other. As the plans we administer continue to grow, we are facing a real opportunity. One of the things we offer is a model and a foundation for collaboration on a much larger scale than what is currently occurring within the Church. We have many separate operations within the Church. Many dioceses and religious institutes have consolidated those resources together into a single operation, whether it's a pension plan or health care plan, or insurance plan. Much larger Catholic Church cooperative plans could be created in all kinds of areas. For example, in the Prescription Drug Program, we work with other church denominations that have health benefit programs like ours. The cost of prescription drugs is significant. Together, we've built up a very large purchasing cooperative that each organization uses to reduce drug costs. The cooperative purchasing program gives us economic power in the marketplace far beyond what any one of us could accomplish separately. By working together, we have attained something no one of us could have done on our own.

CBS was founded on the principle of encouraging the Church to work together. As we look to the future, this concept is still relevant today. We welcome the opportunity to help the Church bring about a greater spirit of collaboration to meet our collective managerial needs. ■

Finding Value in Global Markets

A Conversation with Causeway Capital's Sarah Ketterer

AN INTERNATIONAL ALLOCATION can function as a hedge for a U.S. domestic portfolio, offering the potential for positive returns when domestic stocks are weak, benefiting from a falling U.S. dollar and capturing the value created by financially strong companies located in the many other developed nations around the world.

A co-manager (along with Jarislowsky Fraser) of the [CUIT International Equity Fund](#) since February 2005, Causeway

Capital is an independently owned international equity investment manager with more than \$13 billion in assets under management. Causeway invests primarily in developed, liquid markets and structures the portfolio to produce an above-average yield while minimizing downside risk. In a conversation with CBIS conducted via email in early October, Causeway CEO Sarah Ketterer offered her perspective on international investing and how she finds value in global markets.

CBIS: What are the key traits that differentiate Causeway from other international value investors?



Sarah Ketterer: Causeway builds portfolios with the most undervalued stocks we can identify without constraints relative to an international index.

We are unique in this unconstrained approach, in our intensive research, and in our proprietary risk model used to mitigate portfolio volatility. Our philosophy is that if we can produce competitive returns with below-market volatility over a market cycle, then, over time, it is the compounding of these less-volatile returns that will allow us to gravitate to the top quartile of our peer universe.

CBIS: As a value investor, what are the key attributes you look for in potential investments?

SK: We screen for stocks with a payout yield in excess of their local market average and which have a prospective earnings yield that exceeds the local ten-year government bond yield by an equity risk premium. This identifies companies that typically have relatively low reinvestment requirements. The second part of the screen examines price-to-cash flow within the relevant industry in conjunction with earnings

estimate revisions. The screen identifies undervalued companies whose earnings are at a turning point. Once the screens narrow the field of candidates, our valuation work typically centers on a company's ability to generate free cash flow (cash not needed for operations). The present value of this future stream of cash, discounted by the company's own cost of capital, gives us a two-year target price. Stocks trading below our target prices generally make excellent investment opportunities.

CBIS: The S&P 500® and European large-cap returns have tracked pretty closely for the past decade measured in local currency terms. Has the increasingly globalized financial system eroded the diversification value of European exposure for U.S. investors? From a valuation perspective, do international stocks currently offer an attractive alternative to U.S. investing?

SK: The increasing correlation between the U.S. market and the foreign markets has not overwhelmed the diversification benefit of investing abroad. (See *Figure 1*). The foreign equity markets, measured by the MSCI EAFE Index® (composed of 21 developed countries in Western Europe, Asia, New Zealand, and Australia) have lower volatility than the S&P 500. As a result, adding a lower volatility asset class to a U.S. portfolio lowers the overall risk of the portfolio. We firmly believe that developed international markets remain inefficient and

lend themselves to mispriced opportunities that the disciplined value investor can exploit. From a valuation perspective, international stocks presently trade at 10-20% discounts to U.S. stocks (See *Table 1*).

CBIS: European economic growth has been sub-par in recent years, French and Dutch voters rejected the European constitution over the summer, and the region has some of the world's highest wages. Can Europe compete in a global economy? What is your perspective for investing in Europe currently?

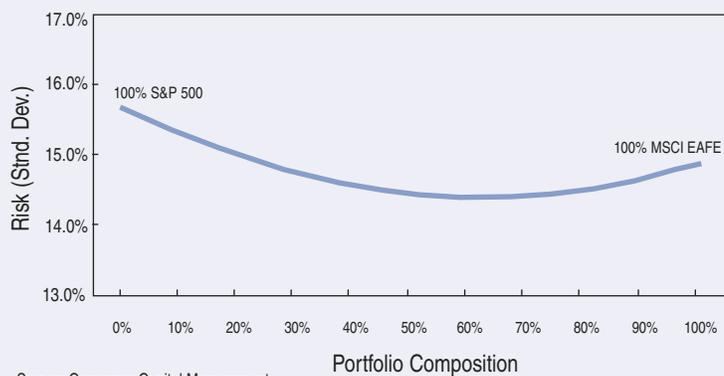
SK: Europe can compete and will be forced to reform its inflexible labor practices. Without such reform, Europe would experience an exodus of businesses and severe damage to its tax base. I mentioned earlier that we are unconstrained to a specific benchmark, which means that we often have geographic and industry exposure that differs dramatically versus an index. Approximately two-thirds of our current portfolio is allocated to Europe rather than Asia. Therefore, one can deduce that we are finding plenty of European stocks that are currently undervalued.

CBIS: Japan appears to be emerging from its decade-long slump. Is this for real or another false start? How are you positioning the portfolio within Japan and what impact would a resurgent Japan have on international returns?

SK: Our investment process is bottom-

Figure 1. Diversification Benefit of International Exposure

(10 year period ending 9/30/2005, monthly data)



Source: Causeway Capital Management

Table 1. Comparative Valuation

(at 9/30/2005, in U.S. dollars)

Region	P/E	P/BV	P/CF	Yield
MSCI USA®	18.3	2.9	12.1	1.8%
MSCI EAFE®	16.3	2.3	9.4	2.4%
Germany	17.4	1.7	6.5	2.2%
Japan	22.0	1.9	9.0	1.1%
U.K.	13.7	2.5	9.7	3.2%

P/E = price/earnings
P/BV = price/book value

P/CF = price/cash flow
Yield = dividend yield

MSCI EAFE includes the following markets: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, United Kingdom.

Source: Causeway Capital Management

up; we buy stocks, not markets. The economic recovery in Japan, albeit gradual, does appear self-sustaining. We factor in that slow recovery in our earnings expectations for Japanese companies in various industries. We have become more sanguine on the outlook for companies in the finance sector as a result of this economic revival.

CBIS: China's booming economy has forced global commodity prices way up and made headlines around the world. But many economists warn of a shaky banking system and an inevitable hard landing. What's your China outlook and how would a slowdown here impact the global economy?

SK: China will eventually experience a slowing of GDP growth as it endures the inevitable business cycle. Such a slowing will have a dramatic impact on the prices of many commodities and inputs. Although unlikely, a hard landing in China would have severe implications for the global economy, with Japan and other Asian countries especially vulnerable.

CBIS: What role do emerging markets play in the portfolio?

SK: We confine our investable universe to the developed (and shareholder friendly) equity markets including those on the cusp of graduation to developed status such as South Korea.

CBIS: Fed Chairman Alan Greenspan recently warned that growing protectionist sentiment in the U.S. Congress might threaten free trade and undermine long-term global economic growth? Do you see this as a concern?

SK: Protectionist sentiment seems more prevalent when economies slow and jobs are threatened. We do not expect protectionism to thrive given the moderate level of growth of the G-7 countries in the next few years.

CBIS: What are the key themes that are currently driving portfolio positioning?

SK: Although our bottom-up process does not rely on investment themes, we see some obvious characteristics in portfolio holdings. Many of the most undervalued stocks globally are in areas of their local economy considered to be moribund. We disagree and ascribe earnings setbacks to the business cycle. The U.K.'s largest do-it-yourself retailer, Kingfisher, is an example. While our clients await the inevitable recovery in sales, Kingfisher is paying a generous dividend and repurchasing shares outstanding. Our clients are paid to wait for the market to recognize the undervaluation.

CBIS: What are some other individual companies you're excited about?

SK: Many of our most promising investments are in the more unpopular areas

of the international equity markets such as retailing, media and transportation. In addition to Kingfisher, France's Carrefour is an example in retailing, where they are the second largest retailer in the world through their chain of hypermarkets and supermarket stores located in Europe, Latin America, and Asia. The Anglo-Dutch publisher, Reed Elsevier, owns the legal resource LexisNexis and many scientific journals, among other publications. Another media holding is the U.K.'s Reuters, a major provider of information and software for financial services professionals in a two-player market. Its major competitor is Bloomberg.

We own a number of transportation infrastructure companies that generate tremendous free cash flow such as the U.K.'s BAA, which operates Heathrow, Gatwick and Stansted airports, as well as Australia's Macquarie Airports, which manages the Sydney airport, Rome's airport and several others. Three other transportation holdings include toll road operators such as Macquarie Infrastructure, Spain's Cintra Concesiones and France's Vinci. These companies have long-term lease contracts ranging from 25 to 99 years and are experts in helping financially strapped local jurisdictions ease traffic gridlocks.

CBIS: Thanks, Sarah. ■

SRI Issue Focus: Responsible International Banking

BECAUSE THE WORLD'S POOR ARE especially vulnerable to the negative social and environmental impacts of poorly planned infrastructure development and other large-scale industrial projects, CBIS and other SRI investors attempt to use our power as shareholders to influence the policies of global banks as underwriters, lenders and advisors in this area.

Global financial institutions often provide critical financing for large-scale projects such as coal-fired power plants, dams, oil and gas pipelines, mines and scores of other potentially controversial projects around the world. However, absent a clear understanding of key environmental and human rights issues, banks may expose themselves to unnecessary risks to their reputation and financial position.

Failure to address environmental, social, human rights, and other non-financial risks can expose a company to the potential for severe public criticism that may damage its reputation and impact its bottom-line. Financial institutions that do not adequately investigate the companies and projects they finance run higher risks that project permits will be revoked due to environmental violations, that health hazards will be incurred due to improper labor practices, and that large-scale protests or work stoppages will occur due to outraged local citizenry.

Proactive Risk Management

As a long-term investor in international banking institutions, CBIS believes that forward-looking leadership and a proactive approach to minimizing such risks can positively contribute to long-term success. For the past several years, CBIS has been leading a dialogue with [JPMorgan Chase](#) and participating in a dialogue with [Citigroup](#) to encourage

both banks to strengthen their approach to risk assessment by incorporating non-financial factors that may negatively impact their valuable brand names and shareholder value. While banks are adept at controlling financial risk, many lack the policies, staff expertise, training or incentive systems to effectively identify and evaluate social and environmental risks.

Our dialogue with JPMorgan Chase achieved a major success in April 2005, after three difficult years of negotiation, when the company agreed to integrate

“Failure to address environmental, social, human rights, and other non-financial risks can expose a company to the potential for severe public criticism that may damage its reputation and impact its bottom-line.”

environmental policies into its global financing decisions, research activities, employee training, and internal operations. As part of its policy, the bank agreed to follow the Equator Principles, which were created by Citigroup and other large global banks, based on the environmental guidelines of the World Bank. JPMorgan Chase's new policies include the commitment to discontinue financing projects in areas that are considered environmentally sensitive and to protect the land and livelihood of indigenous peoples, ensuring that these communities are

consulted during the project evaluation period and before a commitment has been made to fund a project. Another key policy component includes the commitment to encourage bank clients that are large greenhouse gas emitters to develop carbon mitigation plans to reduce emissions.

Citigroup, an original signatory to the Equator Principles, continues to excel in its approach to environmental and social issues. CBIS and other concerned shareholders remain impressed with both the scope and depth of Citigroup's efforts to include steps to reduce these risks in its core business processes. The company has hired a Senior Director of Environmental and Social Risk and publishes a corporate citizenship report that is now used as a benchmark in the industry.

We will continue to monitor both bank's financing of potentially controversial projects and to encourage each bank to improve its approach to risk assessment when financing extractive industry projects.

Shaping Sustainable Banking

CBIS has also been an active player in shaping the direction of sustainable global banking.

We are currently participating in an international working group of The United Nations Environment Programme Finance Initiative (UNEP FI), a global partnership between the UN and the private financial sector. UNEP FI works with over 200 financial institutions around the globe to identify and promote the adoption of best environmental and sustainability practices at all levels of financial institution operations.

CBIS has been invited to present on the achievements made through our work in the sector at UNEP FI's 2005

annual conference, recognized as the principal event on sustainability in the finance sector.

In addition, for the past three years CBIS has been working with UNEP FI and The Global Reporting Initiative (GRI) to develop and disseminate globally applicable guidelines for standardized reporting and to create envi-

ronmental reporting guidelines for financial institutions.

Disclosing more and better information to stakeholders can enable banks to better report on their environmental and social performance while providing shareholders with the key data required to evaluate banks' financing practices. By joining with representa-

tives from business, accounting, investment, environmental, human rights, research and labor groups from around the world, the working group has developed a set of criteria for banks to include in their annual sustainability reports. ■

SOCIAL RETURN in 2005: A Recap

By leveraging the power we possess as shareholders, CBIS and our participants help promote better corporate behavior in areas such as governance, wage justice, environmental sustainability and human rights. We call this the "social return" of our investment programs. By targeting investing's double return—financial return and social return—we believe that Catholic institutions can align their mission with their investments and unify faith and finance. Following are examples of the social return that resulted from CBIS' active ownership initiatives in 2005.

After [American Electric Power](#) released its report on the implications of climate change to shareholders, four major U.S. power companies (Southern, TXU, Cin-

ergy, and Reliant) agreed to produce a similar report. Cinergy has gone even further and supports mandatory caps on greenhouse gases.

[Best Buy](#) has created policies to prevent minors from purchasing violent video games.

[Ford](#) completed a leading-edge corporate social responsibility report with input from stakeholders (including CBIS), agreed to publish a report identifying business risk associated with climate change, and announced a strategy to substantially increase production of hybrid engine vehicles within the next few years.

[Gillette](#) agreed to our request to elect its directors annually (prior to being acquired by Proctor & Gamble, which subsequently declassified its board).

[JPMorgan Chase](#) has developed a leading edge social policy for its international investing activities.

Our proposal at [Merck](#) to separate the Chairman and CEO positions received a preliminary result of 46.6% vote. Following the annual meeting, the company's Chairman and CEO resigned and the new CEO was not appointed Chair.

[Occidental Petroleum](#) released a new human rights policy and reported a number of steps toward implementation.

[VF Corp.](#) agreed to evaluate the labor rights standards in its factories.

[Wells Fargo](#) agreed to adopt a number of policies prohibiting predatory lending practices.

[Yum! Brands](#) agreed to support labor rights at its contract suppliers. ■

Protect Yourself from Identity Theft

CBIS encourages all participants to register for [E-Delivery](#) and [Statements On Line](#), and receive CBIS communications and account information over the web instead of by regular mail.

The internet is a safe medium for transacting business—provided basic steps are taken to preserve your privacy and security.

Careless use of the internet, however, can expose the web surfer to the risk of identity theft. This occurs when personal information is stolen by hackers or through clever fraud (such as email directing you to a fake bank

web site that asks for your username, password and other private account information).

What CBIS Does to Ensure Security

■ CBIS uses SSL encryption (the highest available security standard) to encrypt all private data transmitted to and from participants' web browsers.

■ CBIS will never ask for a participant's password via email.

■ CBIS will never transmit sensitive account information via email.

What You Can Do

■ Make sure your computer worksta-

tion has up-to-date firewall software.

■ Make sure your computer workstation has up-to-date virus protection.

■ Regularly update your operating system to make sure you receive the latest software patches.

■ If your RCT Cash Resource Card is lost or stolen, please call Participant Services at 800-592-8890 immediately.

All participants should feel safe and secure when doing business with CBIS over the internet. Please contact your CBIS Investment Advisor if you have any questions or concerns.



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Announcements

■ Fourth Quarter 2005 Holiday Office Closings

CBIS offices will be closed Thursday, November 24th for Thanksgiving and Monday, December 26th for Christmas.

■ Visit the CBIS Shareholder Advocacy Directory

For SRI issue overviews and updates on the status of CBIS' Active Ownership initiatives, please visit the Shareholder Advocacy Directory in the SRI section of the CBIS website (www.cbisonline.com).

Your CBIS Investment Advisor is ready to assist you.

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