Baird Mid Cap Growth Institutional BMDIX

Typically outperforms in down markets.

Morningstar's Take BMDIX

Overall Morningstar Rating™ ★★★★
521 US Fund Mid-Cap Growth
(31 May 2023)

	3 Yr 521 funds	5 Yr 490 funds	10 Yr 382 funds
Morningstar Rating™	4★	5★	4★

Morningstar Medalist Rating™	Bronze
Analyst-Driven %	100.00
Data Coverage %	100.00

Morningstar Pillars	
Process (6 Jun 2023)	Average
People (6 Jun 2023)	Above Average
Parent (25 Mar 2022)	High
Performance (6 Jun 2023)	
Price (6 Jun 2023)	

6 Jun 2023 | by Stephen Welch

Veteran managers steer Baird Mid Cap Growth using a quality-oriented, time-tested approach. It earns a Morningstar Medalist Rating of Bronze across both share classes.

This team doesn't lack experience. Lead manager Chuck Severson has overseen the fund since its 2000 inception and a similar separate account dating to 1993. Comanager Kenneth Hemauer has worked on the fund since 2001 as an analyst, becoming a named manager in mid-2010. Six analysts round out the team, three of whom have over a decade of experience with the fund.

The team utilizes a time-tested approach that has reasonable guardrails. Focused on profitable firms within the market-cap range of the Russell Midcap Index, the team looks for companies like longtime holding Fastenal FAST. It is the largest fastener distributor in North America with a low debt/capital ratio and an above-benchmark return on invested capital. Its stock has outpaced the index by roughly 8 percentage points annualized since Severson first purchased it in late 2002. While fundamental analysis is key to identifying such companies, Severson and team also use quantitative and technical overlays for position-sizing and transaction decisions.

Severson often pays a premium for above-average profitability in building the fund's roughly 55- to 60-stock portfolio. Over the past decade, the fund's trailing 12-month price/earnings ratio was on average more than 20% higher than the Russell Midcap Growth Index's. Even when the kind of profitable, debt-light firms Severson favors can be had at a bargain, he's cautious about buying companies on his roughly 10-stock watchlist.

The fund's quality tilt has buoyed it in most down markets, such as 2020's coronavirus-driven plunge. However, in 2022 it slightly underperformed the index partly because of its energy underweight and picks within healthcare and industrials. As growth rebounded in 2023's first quarter, the strategy bounced back and landed in the top decile of the category. Its usual ability to lose less in market pullbacks has resulted in lower volatility than the index and better risk-adjusted results during Severson's 20-plus years in charge.

This fund continues to be a promising option.

Process Average | Stephen Welch | 6 Jun 2023
The strategy's quality-oriented approach is straightforward and well-executed, but the fund's reliance on sell-side research and tight sector constraints warrant an Average Process rating.

Focused on stocks within the Russell Midcap Index's market-cap range, manager Chuck Severson and his team look for companies with five characteristics: attractive margins, durable revenue growth, capable management, industry tailwinds, and favorable market expectations. The team pays attention to valuations, often using Wall Street research to aid in the process, but isn't afraid to buy expensive but well-run growers. Overall, though, the fund typically favors profitable, debt-light firms that can sustain above-average earnings and revenue growth for at least three to five years.

The fund uses a quant screen as a fundamentals-check and a technical screen to gauge sentiment, which helps it time buying and selling. But it isn't beholden to those filters. Annual portfolio turnover isn't excessive, ranging between 26% and 47% the past five years. While most holdings take up 1% to 3% of assets, the fund can build up to a 4% position in firms with quant and technical screen support and it holds on to them unless their growth slows.

The team is sector aware and limits relative risk by keeping sector weightings to 75% to 125% of the index's. Severson will sell names whose market caps become too big for the benchmark.

This fund is fairly diversified across 55-60 stocks, its typical range since mid-2008, with around a fourth of assets in its top-10 holdings. Still, the fund favors some sectors more than others, while shunning not-yet-profitable biotech firms and highly leveraged companies, including most REITs, utilities, and airlines. The fund also does not invest in unprofitable businesses, now more than 10% of the Russell Midcap Index.

Chuck Severson keeps a watchlist of roughly 10 stocks and will wait to buy a name from the list until the company's results improve. That entails paying a premium for stocks. For example, he waited for O'Reilly Automotive ORLY to resolve its sales issues in 2017 before buying the stock in early 2018; by then, its share price had recouped somewhat. Indeed, the fund's average trailing 12-month price/earnings has averaged 16% higher than the index over the past five years.

Severson tempers price risk by sticking to high-quality fare. Overall, the fund's net margin levels have been higher and its debt/capital levels lower than the index's during his tenure. During 2022, Severson swapped out picks to more heavily emphasize companies with balance sheet strength, durability, and growth. He also added a few healthcare names during the pullback, such as Doximity DOCS, which Severson believes are poised for growth.

People Above Average | Stephen Welch | 6 Jun 2023
This strategy's veteran managers support an Above Average People rating.

Lead manager Chuck Severson has been in charge since the fund's year-end 2000 inception, but his experience with the strategy goes beyond that. A 36-year veteran of Robert W. Baird & Co, Severson has used the same process on the separate account Baird Mid-Cap Growth Equity since June 1993, which successfully navigated the market drawbacks in 1998 and 2000.

Severson isn't alone. Comanager Kenneth Hemauer initially joined the fund in 2001 as a financials and consumer analyst and became a named manager in mid-2010. Hemauer still covers the financials sector.

The two managers work as part of a stable but growing eight-person team. Five have worked together for more than a decade and one has been with the team for four years. The industrials analyst and the healthcare analyst each came to the fund more than 10 years ago, with 20 and seven years of prior experience, respectively. The consumer analyst joined the team in mid-2014, after roughly four years on Baird's sell-side research team. There was a change to the technology analyst position in April 2019, but the new analyst who joined isn't a neophyte. He came with three years of investment experience and spent over a decade in the technology industry before that. Severson added an analyst in 2021 and another in 2022. He plans to add one to two more members during the next few years for additional support. This will ensure there is adequate help after launching a smid-growth strategy a few years ago.

Severson and Hemauer each have over $1 million in the fund.

Parent High | Stephen Welch | 25 Mar 2022
Baird's best-in-class stewardship attributes and investor alignment deserve a Parent rating upgrade to High from Above Average.

The firm's taxable-bond franchise, which boasts low fees, a well-resourced team, and a risk-aware investment process across its strategies, has garnered considerable investor attention over the past few years. It swelled from $37 billion in 2016 to $120 billion at the end of 2021, encompassing 85% of the firm's total $139 billion in assets. This growth bears monitoring, but longtime CIO and lead fixed-income portfolio manager Mary Ellen Stanek has shown prudence in adding personnel and operational resources to manage this considerable load. She has also been circumspect in succession planning and elevated her veteran deputy Warren Pierson to co-CIO in October 2021. Though the firm's municipal-bond and equity franchises are much smaller, they also sport sensible leadership and many of the same positive attributes as the taxable fixed-income lineup.

Baird has long supported its investors by providing transparent reporting on its own firm and its investment rationale through timely market updates and webinars. Internally, the firm is also keen to encourage employee retention and engagement: Turnover among the firm's analyst staff has historically been low, and around two thirds of employees owned stock in the privately held firm at the end of 2021.

Performance | Stephen Welch | 6 Jun 2023
The fund has performed well under its longest-tenured manager Chuck Severson. Since his year-end 2000 start, the institutional shares' 8.3% annualized gain through April 2023 beat the Russell Midcap Growth Index's 7.4% and the typical mid-growth Morningstar Category peer's 5.8%. The fund has been less volatile than the index resulting in its superior Sortino ratio (a measure of risk-adjusted results) during that stretch.

The fund got much of its edge from faring well in volatile markets, like 2020's first-quarter coronavirus-driven plunge. It has delivered in most market corrections, like in the financial crisis, 2011's third quarter, 2012's second quarter, and late 2018's drawback. In 2022's market pullback, the strategy did slightly lag the index in large part due to its energy underweight and picks within healthcare and industrials. As growth rebounded in 2023's first quarter, the strategy recovered, outperforming the index and landing in the top decile of the category.

The fund can lag for extended periods, whether in rallies that favor more aggressive peers or value-oriented markets that reward the kind of income-oriented sectors it typically eschews. Treading lightly in real estate and utilities hurt from mid-2004 to mid-2007, for example. The fund also finished behind the index each calendar year from 2013-16 and 2020.

Price | Stephen Welch | 6 Jun 2023
It's critical to evaluate expenses, as they come directly out of returns. Based on our assessment of the fund's People, Process, and Parent Pillars in the context of these expenses, we think this share class will be able to deliver positive alpha relative to the category benchmark index, explaining its Morningstar Medalist Rating of Bronze.

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