

Baird Small/Mid Cap Growth Equity

MARKET UPDATE

The stock market absorbed the 10th interest rate increase of the current tightening cycle, stared down the risk of a U.S. default, and continued the recovery from a difficult 2022. Whether it was the debt limit deal, a pause in rate hikes by the Federal Reserve, or continued favorable employment data, stocks indices rose in the second quarter and capped off a solid first half.

PORTFOLIO COMMENTARY

The Baird Small/Mid Cap Growth strategy increased +3.4% in the second quarter, net of fees, compared to the +6.4% increase in our primary benchmark, the Russell 2500 Growth Index. The portfolio lost relative performance early in the quarter as index returns were roughly flat, but performed well during the broader market rally in June. Our bias to more profitable, higher multiple stocks proved to be a headwind as stocks with low or negative margins and lower valuations outperformed.

The best performing sector on a relative basis was consumer discretionary, led by portfolio holdings Deckers, LGI Homes, and Pool Corp. Deckers continues to see strong growth from its HOKA brand of running shoes, and we are encouraged by the company's ability to thoughtfully manage various retail channels for the brand over the last several years. Both LGI and Pool Corp continue to benefit from strong consumer demand in housing, despite the uptick in mortgage rates in the past year. During the quarter, we made minimal changes to the sector other than initiating a position in Churchill Downs, owner of the iconic Churchill Downs Racetrack and other regional racetracks and casinos. We believe the business has a superior management team with a strong record of capital allocation.

Other sectors that were positive relative contributors in the quarter were three of the smaller sectors in the Russell 2500 Growth Index: energy, consumer staples, and financials. The energy sector helped relative performance due to positioning, as our sector underweight proved helpful against a backdrop of lower oil prices and concerns about future energy demand should the economy weaken. Notably, both our oilfield services and exploration & production holdings had positive returns in the quarter. We exited our position in SolarEdge as we lack conviction in the longer-term growth story in what we view is an increasingly crowded and competitive industry. Our consumer staples returns were led by our best performing stock in the first half of the year, VitaCoco. The stock continues to benefit from consumer preferences for coconut-based drinks, as well as an improving supply chain that should drive superior profitability throughout 2023. The financials sector was modestly positive for the strategy on a relative basis, although the sector was the worst performer in the benchmark on an absolute basis. Kinsale was a bright spot in the sector with exposure to the favorable pricing environment in the insurance industry. MarketAxess declined in response to subdued bond trading activity, which was attributable to low volatility and benign credit spreads. The company produces strong profitability metrics, but a better volume environment is likely needed to drive stock outperformance. With respect to portfolio changes, we initiated a position in Clearwater Analytics, which is a software business within the financials sector that provides an automated platform for investment accounting, performance, and compliance solutions for insurance, equities, and fixed income asset managers.

The healthcare sector netted out slightly negative on a relative basis. A return to more regular seasonal surgical volumes aided several positions, including fast growing medical technology holdings Shockwave and Inspire. Surgical instrument leader, CONMED, benefited from improving volumes as the company recovers from operational challenges at the end of 2022. Longtime holding ICON also contributed positively to relative performance as the company continues to execute well in a challenging environment for smaller biotech companies facing financing challenges. Additionally, Exact Sciences continues to inflect positively as the company is seeing both improving sales growth and faster improvement to profitability. Offsetting those gains were several detractors to performance. The impact of more constrained spending for drug development hurt Catalent, which delivered the largest drag on the sector's performance. Repligen also sold off in sympathy with weak reports from Danaher and other peers in bioprocessing. We exited our position in Catalent as the challenging revenue backdrop was made worse by a surprise announcement revealing significant operational issues at numerous production facilities, along with the termination of its CFO. Additional headwinds to performance were from iRhythm, due to additional regulatory hurdles from the FDA; Insulet, with concerns over future competition after Medtronic acquired a patch-pump company; and Revance Therapeutics, after continued investor debate about the launch trajectory of a new product in a weakening macroeconomic environment. With respect to adjustments throughout the quarter, we added to our positions in Exact Sciences and Biotechne. We also reduced our position size in Quidel due to a potentially longer regulatory pathway existing and Repligen, as there are continued elevated channel inventories pressuring growth.

Baird Small/Mid Cap Growth Equity (Q2 2023)

The industrials sector was a relative detractor from second quarter performance as we were unable to keep pace with a roughly 9% gain in the benchmark. We saw solid gains in several stocks, such as Trex, MasTec, GXO Logistics, and Watsco, which we attribute to improving fundamentals as recession fears never materialized in the quarter. We also witnessed a favorable price recovery in Chart Industries as investors began to acknowledge improved growth potential from a recent acquisition last year. Trex showed positive appreciation in the quarter as the worries over elevated inventory in the channel subsided after a positive earnings result. Those gains were offset mostly by three stocks: Shift4 Payments (which we consider more of a financials business), IDEX Corp., and WNS Holdings. Shift4 Payments sold off modestly in the quarter, we believe it was simply giving back some of its return from stronger appreciation in the first quarter. IDEX Corp. reduced their earnings guidance for calendar year 2023 due to high inventories in their life sciences segment, which is an issue affecting the entire industry and is no reflection of the company's fundamental execution. While the market believes WNS may face significant headwinds from artificial intelligence, we remain encouraged by the growth and margin profile of the company. Lastly, throughout the quarter, we made a handful of changes to position sizes, adding to Kadant, Trex, Jack Henry, and GXO Logistics.

The benchmark's technology returns were also quite strong, appreciating over 10%. Signs of stabilization in company fundamentals and a seemingly singular focus on artificial intelligence, punctuated by NVIDIA's better-than-anticipated earnings, drove meaningful appreciation in many tech stocks. As a result, technology was the largest relative detractor to performance in the quarter as we experienced a handful of stock setbacks. Sprout Social declined after reporting disappointing earnings showing increased churn in their small business client base. We saw mixed results from IT services companies, Globant and Endava. Globant's results were much stronger, while Endava's stock declined over 20% in the quarter due to continued worries over future technology spending in a potential recession. We reduced our exposure in the sector by trimming our position size in Globant and exiting Endava. Given similar macro worries, both of our semiconductor holdings, SiTime and Lattice Semiconductor, were relative detractors in the quarter. Additional portfolio adjustments included selling Paycor (while keeping our position in Paylocity), adding to Tyler and PTC, and adding back to Lattice after trimming it earlier in the quarter in front of its annual analyst meeting. We also initiated a new position in ZoomInfo Technologies, which provides a go-to-market intelligence platform for sales and marketing professionals. We believe a combination of bottoming tech-related spend and an attractively valued stock made for a good entry point.

OUTLOOK

Economist Milton Friedman was known for saying that monetary policy affects the economy with lags that are both long and variable. Such is the conundrum of market prognosticators trying to call the next recession amid a Federal Reserve tightening cycle that may have one or more rate hikes to go. There is little question that in combination, elevated inflation, and the Fed's aggressive series of rate hikes over the last 15 months have taken a toll.

Six months ago, the thought of an aggressive tightening cycle ending in a soft landing was viewed as a low probability scenario. Now, with strong returns in the first half and still resilient employment data, the stock market appears to have lifted the odds. With a lag – time will tell. We have found the best way for our team to achieve the goal of delivering long-term outperformance with less risk, is to remain informed about the macro forces that can affect our companies, as well as focus on investing in companies led by management teams that are developing competitive advantages and demonstrating the ability to effectively allocate capital and drive sustainably attractive growth and returns.

On behalf of the entire team at Baird Equity Asset Management, we thank you for your support of our Small/Mid Cap Growth Strategy.

Baird Small/Mid Cap Growth Equity (Q2 2023)

PERFORMANCE

Periods Ending June 30, 2023* (%)	Total Return (%)		Average Annual Total Returns (%)			
	QTR	YTD	1 Year	3 Year	5 Year	Since Inception (09/30/2015)
Baird Small/Mid Cap Growth Composite (Gross)	3.65	13.36	15.98	9.92	11.65	14.71
Baird Small/Mid Cap Growth Composite (Net)	3.43	12.90	15.00	9.01	10.71	13.77
Russell 2500 Growth Index	6.41	13.38	18.58	6.56	7.00	10.37

*Returns over one year are annualized unless otherwise specified. Performance data represents past performance and does not guarantee future results. Current performance data may be lower or higher than the data quoted. For performance data to the most recent month end, contact Baird Equity Asset Management directly at 800-792-4011.

TOP & BOTTOM CONTRIBUTORS

Top 5 Portfolio Contributors	Avg. Weight	Contribution
Inspire Medical Systems, Inc. (INSP)	2.19	0.74
Vita Coco Company, Inc. (COCO)	2.13	0.70
CONMED Corporation (CNMD)	2.03	0.57
Watsco, Inc. (WSO)	2.78	0.56
Exact Sciences Corporation (EXAS)	1.34	0.48

Bottom 5 Portfolio Contributors	Avg. Weight	Contribution
Repligen Corporation (RGEN)	1.83	-0.28
Sprout Social, Inc. (SPT)	1.15	-0.30
Catalent Inc (CTLT)	0.20	-0.40
MarketAxess Holdings Inc. (MKTX)	1.14	-0.52
WNS Holdings (WNS)	2.03	-0.53

BAIRD SMALL/MID CAP GROWTH INVESTMENT TEAM

Investment Professional	Years of Experience	Years with Baird	Coverage Responsibility	Educational Background
Jonathan Good Portfolio Manager	23	17	Healthcare	MBA – (Northwestern University-Kellogg) BS – Applied and Biomedical Sciences (Pennsylvania)
Ken Hemauer, CFA Senior Research Analyst	29	29	Financials	MS – Finance, The Applied Security Analysis Program BBA – Finance (UW-Madison)
Corbin Weyer, CFA, CPA Director of Research & Senior Research Analyst	13	13	Consumer Discretionary & Staples	BSBA – Finance and Accounting (Marquette University)
Doug Guffy Senior Research Analyst	39	19	Energy, Industrials & Materials	MBA – Finance (Ball State University) BA – Economics & Government (Anderson University)
Karan Saberwal Senior Research Analyst	7	4	Information Technology	MBA – (Northwestern University-Kellogg) BE – Bachelor of Engineering (Army Institute of Technology, University of Pune)
Josh Heinen Research Analyst	2	2	Healthcare & Financials Focus	MS – Finance, The Applied Security Analysis Program BBA – Accounting and Finance (UW-Madison)
Margaret Guanci Research Analyst	1	1	Technology Focus	BBA – Finance (UW-Madison)
Chuck Severson, CFA Mid Cap Growth PM	36	36	Generalist	MS – Finance, The Applied Security Analysis Program BBA – Accounting and Finance (UW-Madison)

This commentary represents portfolio management views and portfolio holdings as of 06/30/23. Those views and portfolio holdings are subject to change without notice. The specific securities identified do not represent all the securities purchased, sold or held for accounts and you should not assume these securities were or will be profitable.

Positions identified above do not represent all the securities held, purchased or sold during this time period. The contribution to return of these securities is calculated by multiplying the weight of the security at the beginning of the time period by the security return and represents a model portfolio. To obtain a complete list of positions and contributions for the period, please contact Baird Equity Asset Management at 800-792-4011.

Composite's returns are presented gross and net of management fees and include the reinvestment of all income. Composite performance is presented gross of foreign withholding taxes on dividends, interest income, and capital gains.

The Russell 2500® Growth Index measures the performance of those Russell 2500 companies with above average price-to-book ratios and higher forecasted growth values. When sorted by market cap, the Russell 2500® Index consists of all of the companies in the Russell 3000® Index, except for the 500 largest companies by market capitalization in that index. The Russell Indices are a trademark of the Frank Russell Company. Indices are unmanaged and direct investment is not possible. Past performance is no guarantee of future results.

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