

Baird Small/Mid Cap Growth Equity

MARKET UPDATE

Equity markets took a step down in the quarter, giving back a portion of first half gains. A notable run-up in interest rates reflecting still above trend inflation, a healthy labor market with rising wage rates, and a growing concern about the domestic fiscal situation was too much for stocks to handle.

PORTFOLIO COMMENTARY

The Baird Small/Mid Cap Growth strategy declined -8.9% in the third quarter, net of fees, compared to the -6.8% decrease in our primary benchmark, the Russell 2500 Growth Index. Although our strategy has typically provided downside capture during market declines, there were a variety of factors that proved challenging for our strategy in the third calendar quarter. Larger, more profitable, higher return¹ and less levered companies did better than the overall benchmark performance, while more expensive² and faster growing companies fared worse. In addition, though it is no surprise that disappointing earnings reports were punished, we did not see strong quarterly earnings reports rewarded with much upside to offset the weaker results.

Our healthcare holdings, several of which have been long time holdings and strong positive contributors, struggled in the quarter. The sector has historically provided cover during market declines due to the innovation and broad spending required for the sector's services and products irrespective of the economic climate; however, it put up little resistance and fared much worse than other key sectors. Regarding our underperformance, the key pivot point was the release of data supporting GLP-1 drugs as a solution for obesity and reducing long term cardiovascular risks. This development led to a sharp, negative reaction across the medical equipment industry, notably for us – Insulet and Inspire Medical, as well as Conmed and Shockwave to a slightly lesser extent. To date, the market has decided it is a zero-sum game, with positive GLP-1 news pointing to an inevitable shrinkage of the long-term addressable market for diabetes and sleep apnea. Our fundamental work indicates the negative price reaction is overdone relative to the potential end-market impact, and we added to our Inspire position late in the quarter. As much as we would like an immediate resolution to the overhang our companies face, we are comfortable letting time and the anticipated continuation of strong fundamentals address concerns and drive a recovery. Beyond weight-loss drugs, Doximity was another negative performance driver in the quarter, declining meaningfully following quarterly earnings which included further signs of growth deterioration. We sold the position given the outlook and what we saw as a disconnect between management's favorable view of their end-market and actual execution against the opportunity. Offsetting some of these setbacks in the quarter was positive contributions from Icon, Halozyne, and Repligen which recovered from some of their declines earlier this year.

The industrials sector was a similar story, as a few solid performers were not enough to offset earnings reports that surprised to the downside. In particular, five holdings detracted from performance in the quarter. MasTec reduced its guidance given reduced capex spending from wireless as well as delays in spending for its energy business projects. Given this setback, we decided to reduce our position size. Littlefuse also reported earnings below expectations given elevated inventory levels which, in our view, will take a few quarters to normalize. We also reduced our position size in Littlefuse. We did not make any trades to three other detractors in the quarter: specifically, WillScotMobile Mini, which felt worries over a construction spending slowdown; Toro, which experienced a slowdown in its consumer business and elevated channel inventories; and Shift4, which faced worries over a slowdown in consumer spending in travel and entertainment.

Technology was a slight relative detractor in the third quarter. While our original thesis was that the worst of a tech spending slowdown was behind ZoomInfo, that was not the case as the company reduced its guidance. We sold the stock given our thesis was no longer valid. We also exited DigitalOcean after the announced CEO departure, which was a surprise to us after meeting with the company earlier in the quarter. Our final sale in the tech sector was Sprout Social. Although we continue to believe in the management team longer term, the debate among investors over its near-term growth prospects remains contentious so we decided to move on after the stock recovered somewhat from its decline last quarter. Beyond those holdings, we felt our other semiconductor and software stocks held up fairly well in a downward trending market, as Globant, PTC, and Bentley systems were all positive contributors in the quarter.

¹Return on Assets/Return on Invested Capital; ²Price to Earnings/Price to Sales

Baird Small/Mid Cap Growth Equity (Q3 2023)

Rising interest rates and continued elevated inflation have led to increasing questions about the health of the consumer. Underperformance from the consumer discretionary sector was centered in our retail (FiveBelow) and housing-related holdings. Homebuilder LGI Homes and flooring retailer Floor and Décor suffered from rising mortgage rates throughout the period. We established a new position in BJ's Wholesale Club, a membership wholesale club retailer. BJ's, as well as the broader club industry, benefited from Covid-19 acquiring millions of new members, and these members are staying and spending more three years later. Management is accelerating new unit growth and improving its general merchandise mix, which should translate into attractive sales and earnings growth. Newer holding Churchill Downs pulled back on quarterly earnings that fell short of market expectations. We believe their capital allocation acumen will play out over time and we added to the position.

There were bright spots among sector performance in the quarter. The materials sector contributed on the back of RBC Bearings which rose based on a continued favorable aerospace spending outlook. Strong performance in financials was led by both Kinsale, after continued strong growth in their niche insurance markets, and newer holding Clearwater Analytics. Clearwater is a software business used by insurance and asset managers. We believe the company can continue to grow its topline in the low double digits while also expanding margins.

Both of our energy holdings, Matador and ChampionX, were up double digits in the quarter on an absolute basis, roughly in line with benchmark returns. However, quarterly attribution was negative given our underweight in the sector. We added to both positions during the quarter to lessen the underweight.

The consumer staples sector was flat in terms of relative performance. Boston Beer rose nicely after posting quarterly earnings that highlighted margin stabilization and continued strength in its Twisted Tea brand. Lamb Weston declined in the quarter after communicating to investors that the magnitude of pricing increases will no longer be as high as the past several quarters. We trimmed our position size given this development.

OUTLOOK

Thus far in 2023, inflation has receded sharply from its peak but not yet to the Fed's desired level. As a result, the debate over the appropriate amount of tightening and whether enough has been done will continue. The parallel debate of recession vs. soft landing will also likely remain unresolved for several quarters.

What we do know is that the cumulative impact of inflation and interest rate increases has taken a toll, not broadly enough to declare a recession, but enough to impact pockets across sectors. The experience down the market capitalization spectrum is quite different than the top end of the S&P 500. We had our share of downside volatility in the third quarter as well. Where it exposed a flaw in our investment thesis we moved on and worked to take advantage of those situations where we believed the market misperceived risk, or over-reacted to what we viewed as temporary fundamental softness in a good business.

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

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PERFORMANCE

Periods Ending September 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)	-8.70	3.50	6.25	2.59	8.06	12.93
Baird Small/Mid Cap Growth Composite (Net)	-8.90	2.84	5.35	1.73	7.13	12.00
Russell 2500 Growth Index	-6.84	5.63	10.61	1.01	4.05	9.06

*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
Boston Beer Company, Inc. (SAM)	1.63	0.34
Clearwater Analytics (CWAN)	1.37	0.27
Kinsale Capital Group (KNSL)	2.35	0.23
Matador Resources (MTDR)	1.81	0.19
RBC Bearings Incorporated (RBC)	2.03	0.13

Bottom 5 Portfolio Contributors	Avg. Weight	Contribution
Shockwave Medical, Inc. (SWAV)	1.49	-0.51
CONMED Corporation (CNMD)	1.90	-0.53
MasTec, Inc. (MTZ)	1.34	-0.55
Insulet Corporation (PODD)	1.52	-0.83
Inspire Medical Systems (INSP)	1.93	-0.90

BAIRD SMALL/MID CAP GROWTH INVESTMENT TEAM

Investment Professional	Years of Experience	Years with Baird	Coverage Responsibility	Educational Background
Jonathan Good Senior Portfolio Manager	24	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	40	19	Energy, Industrials & Materials	MBA – Finance (Ball State University) BA – Economics & Government (Anderson University)
Karan Saberwal Senior Research Analyst	7	5	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 09/30/23. 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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