Baird Mid Cap Growth Equity

MARKET UPDATE

Stocks and bonds rallied meaningfully during the fourth quarter on the back of a lower-than-expected inflation report in late October. The market quickly declared an end to the Federal Reserve's tightening cycle and began discounting a pivot to multiple interest rate cuts beginning in the first half of 2024. Time will tell if the market read proves correct, but the changed outlook took a nondescript return year for most mid cap stocks and broadened it to a strong positive year for nearly all parts of the stock market.

PORTFOLIO COMMENTARY

The Baird Mid Cap Growth portfolio advanced +13.1%, net of fees, during the quarter, compared to +14.6% for our primary benchmark, the Russell MidCap® Growth Index. Underscoring the market turnaround mentioned above is the fact that both the portfolio and benchmark were down four weeks into the quarter before the sharp rally. While the full-quarter results still lagged the benchmark, we were encouraged by the portfolio's outperformance during the strong move into year-end as we saw the breadth of positive performance spread more evenly across sectors. More detail about performance and changes to the portfolio follow.

We will start with the healthcare sector which recovered from a difficult late summer and early fall to outperform in the quarter. Stocks in the medical equipment industry led the way with DexCom and Insulet rebounding sharply, and ResMed bouncing as well. These stocks came under significant pressure in the previous quarter due to the emergence of weight reducing GLP-1 drugs which raised concerns about the ultimate size of the addressable market for diabetes and sleep apnea. The impact and health benefits of the GLP-1 drugs look to be meaningful; however, we believe the long-term availability, cost, and impact on weight-related health issues has not been fully determined and the initial rush to judgment was overdone. During the third quarter we added to Dexcom, Insulet, and ResMed and while the timing was not perfect, we anticipate a continued, growing need for proven diabetes and sleep apnea management solutions. The additional weight helped relative performance as the stocks rebounded. We look to increase our exposure to the sector in 2024 as returns have lagged other areas of the market over a one and three-year period. Mean reversion is no certainty, but we believe it is a powerful force in investing and pushes the odds in favor of more weight in healthcare stocks. As such, we purchased Bio-Techne, a leader in the development, manufacture, and sale of biotechnology reagents and instruments for the research and clinical diagnostic markets. We believe that the life science tools market has bottomed and Bio-Techne is attractively exposed to fast-growing, secularly advantaged end markets such as cell and gene therapy and molecular diagnostics. We also added capital to comparable healthcare holding, Repligen.

Technology generated the quarter's worst relative performance as our holdings were unable to keep pace with the sharp advance in the broader sector. The performance of unprofitable versus profitable companies continues to be a large swing factor in relative performance as the sector carries a large weight in unprofitable companies. By our work, unprofitable technology companies comprised over 40% of the sector and advanced 25% in the quarter, compared to 14% for the profitable group. We will hold to our rule of requiring profitability as a key measure defining a quality company, despite the periodic performance headwinds it creates. Over time, the profitability requirement has kept us investing in the higher return portion of the benchmark and added value to relative portfolio performance. Note the profitability factor headwind and sector underperformance were concentrated in the software industry. A few of our holdings kept pace, including PTC, ANSYS and Descartes Systems, but more modest advances in Tyler Technologies and Bentley Systems, and a misstep by Paycom Software which sold off meaningfully on a reduced earnings outlook, were too much to overcome.

The consumer discretionary sector delivered a solid quarter of outperformance with contributions across several industry groups. The largest contributors reacted favorably to the move down in interest rates which should lessen pressure on consumers. Companies most directly tied to housing activity, homebuilder D.R. Horton and home improvement retailer Floor & Décor, stood out. Retailers Dollar Tree and Five Below also recovered nicely. As far as changes to the sector, we sold Tractor Supply as we believe sales growth will become more challenged over the next several years. We also trimmed Five Below to moderate the portfolio's retail exposure. We moved some of these proceeds into D.R. Horton which had pulled back late summer into early fall as interest rates moved higher. Secular demand for housing, particularly entry-level homes, should continue to support a favorable fundamental backdrop even amid higher mortgage rates.

Underneath the modest negative relative performance from industrials, we were actively working on the structure of the sector. We sold three positions, purchased one, and made several adds and trims. Our purchase of Cintas, a company we have owned before, gives us exposure to the market leader in uniform rental and related services. We believe the position adds more defense to our industrials sector composition due to the recurring revenue model and stable nature of Cintas' end-markets. We sold Generac over concerns that earnings power will be reduced for longer than we had originally forecasted. We also sold smaller weighted position Euronet, as we believe the capital can be better allocated to higher conviction positions. We sold Toro given long-term concerns over the company's competitive positioning against rising EV/autonomous entrants. Reflecting the sharp move in the market, we had an unusual occurrence of adding to and then trimming two positions intra quarter, Equifax and Cintas, where we felt the short-term moves were outsized.

In financials, a sharp sell-off in specialty insurance provider Kinsale, resulted in a modest drag on relative performance. Kinsale reported solid earnings, but a deceleration in new insurance writings for a company with a high valuation was not well received. We believe the company is well-managed and can continue to deliver strong growth and added to our position on the price decline. We also trimmed Broadridge and MSCI, and added to MarketAxess which has underperformed during our initial ownership period.

The basic materials sector contributed to overall performance on the back of both Fastenal and RBC Bearings, which rose based on good execution and prospects for improvement in end market demand. Consumer staples sector performance offset some of the gains made in materials as Boston Beer gave back a portion of the price strength generated in the prior quarter.

While the energy sector is modest in size, we call it out separately because relative performance led all portfolio sectors. The positive contribution resulted from our underweight sector positioning as energy stocks meaningfully lagged as the market lifted. Our one energy holding, Diamondback Energy, was up modestly versus the sector's collective decline owing to industry M&A activity.

OUTLOOK

History suggests that a "soft landing" is the least likely economic scenario post an aggressive Federal Reserve tightening cycle. However, resilient employment data along with slowing inflation readings have pushed odds higher that the Fed is succeeding in threading the needle, raising rates enough to bring down inflation without killing the economy. Based on the sharp fourth quarter rally, which included a healthy broadening out across sectors and market cap segments, the market base rationale appears to rest on no recession and rate cuts in the first half of 2024. Just writing about lower probability scenarios and threading needles reinforces our belief in remaining diversified across sectors and focused on investing in high-quality, profitable, well-managed businesses that have the best chance of driving good performance no matter the economic path ahead.

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

Baird Mid Cap Growth Equity (Q4 2023)

PERFORMANCE

Periods Ending December 31, 2023* (%)	Total Return (%)	Average Annual Total Returns (%)				
	QTD	1 Year	3 Year	5 Year	10 Year	Since Inception (06/30/1993)
Baird Mid Cap Growth Composite (Gross)	13.28	21.18	2.90	15.28	10.96	12.16
Baird Mid Cap Growth Composite (Net)	13.08	20.30	2.15	14.46	10.17	11.51
Russell MidCap® Growth Index	14.55	25.87	1.31	13.81	10.57	10.10

*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.

BAIRD MID CAP GROWTH INVESTMENT TEAM

Investment Professional	Years of Experience	Years with Baird	Coverage Responsibility	Educational Background
Chuck Severson, CFA Senior Portfolio Manager	37	37	Generalist	MS – Finance, The Applied Security Analysis Program BBA – Accounting and Finance (UW-Madison)
Ken Hemauer, CFA Co-Portfolio Manager	30	30	Financials	MS – Finance, The Applied Security Analysis Program BBA – Finance (UW-Madison)
Jonathan Good Senior Research Analyst	24	17	Healthcare	MBA – (Northwestern University-Kellogg) BS – Applied and Biomedical Sciences (Pennsylvania)
Corbin Weyer, CFA, CPA Director of Research & Senior Research Analyst	13	13	Consumer Discretionary & Staples	BSBA – Finance and Accounting (Marquette 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)
Christopher Brennan Senior Research Analyst	5	<1	Energy, Industrials & Materials	MBA – Finance (The Wharton School of Pennsylvania) BA – Economics and Mandarin Chinese (Washington University in St. Louis)
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)

This commentary represents portfolio management views and portfolio holdings as of 12/31/23. 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 Midcap® Growth Index measures the performance of the mid-cap growth segment of the U.S. equity universe. It includes those Russell Midcap® Index companies with higher price-to-book ratios and higher forecasted growth values. 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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