Baird Aggregate Bond Inst BAGIX

An excellent team and process to match.

Morningstar's Take BAGIX

Overall Morningstar Rating™	★★★★		
416 US Fund Intermediate Core Bond (30 Apr 2023)			
	3 Yr 416 funds	5 Yr 380 funds	10 Yr 282 funds
Morningstar Rating™	3★	4★	4★

MorningstarMedalistRating	Gold
Analyst-Driven %	100.00
Data Coverage %	100.00

Morningstar Pillars	
Process (7 Feb 2023)	High
People (7 Feb 2023)	High
Parent (25 Mar 2022)	High
Performance (7 Feb 2023)	
Price (7 Feb 2023)	

7 Feb 2023 | by Alec Lucas

Appreciation for how Baird Aggregate Bond's' capable and collaborative investing culture pairs with the firm's simple but effective style earns an upgrade of the investor shares' Morningstar Analyst Rating to Gold from Silver, while its institutional shares remain Gold.

Other top-tier firms may have bigger staffs and broader remits; Baird operates differently, and is excellent in its own right. Co-CIO Mary Ellen Stanek, winner of Morningstar's 2022 Outstanding Portfolio Manager award, and co-CIO Warren Pierson head this fund's veteran 10-person management team, whose members complement one another's strengths and stick to a straightforward, winning playbook.

Modest fees are critical to that playbook, allowing the team to focus on U.S. dollar-denominated bonds of investment-grade quality without the complications of derivatives or leverage. The approach begins with matching the Bloomberg U.S. Aggregate Bond Index's overall interest-rate sensitivity and then trying to add value through more repeatable means.

Security selection and sector allocation among corporates, securitized, and government bonds are among those means. As repeated interest-rate hikes weighed on the mortgage market in 2022 for example, the fund leaned in. The managers cut the portfolio's Treasury stake by about 9 percentage points to 22.9% and redeployed most of that money into what they regarded as more attractive securitized exposure, especially U.S. agency residential mortgage-backed securities. They also inched up the fund's financials overweight by year-end even though it had hurt in the first three quarters.

Judged against its benchmark and the distinct intermediate core bond Morningstar Category norm, the fund has an enviable long-term record. Granted, its institutional shares' 13.35% loss in 2022 lagged the index and distinct peer median by 34 and 4 basis points, respectively, but the managers' actions helped the fund outperform in the second half. Moreover, the fund has beaten its index and distinct peer median in eight out of the past 10 calendar years.

The fund is a topnotch choice, especially for investors in search of a conservative option.

Process High | Alec Lucas | 7 Feb 2023

Focused on U.S. dollar-denominated bonds of investment-grade quality without the complications of derivatives or leverage, or the need to clear lofty fee hurdles, Baird Advisors' simple but effective investing style merits a High Process rating.

Citing the difficulty of predicting interest-rate changes consistently, Baird's approach begins with matching this fund's overall interest-rate sensitivity, or duration, to the Bloomberg U.S. Aggregate Bond Index. Aiming to beat this bogy by 25 to 50 basis points per year, gross of fees, the team tries to add value through yield-curve positioning, sector allocation, security selection, and competitive trade execution.

Security selection and sector allocation among corporates, securitized, and government bonds receive the most focus. Whether individual bonds, issuers, or sectors, the team looks for strong fundamental features, attractive relative value, and fit within its broader macroeconomic views. The team does not buy junk bonds but can hold onto debt that has lost its investment-grade rating—a stake that has been 1% or less for more than five years. The fund's credit profile as a result tends to look tame relative to more aggressive intermediate core bond Morningstar Category peers.

The hunt for value even extends to yield-curve strategies for Treasuries. The team looks for incrementally more attractive Treasuries when buying and sells those with the richest valuations.

Corporate credit exposure, especially to industrials and financials, has in recent years accounted for about 40% to 45% of the portfolio's market value, versus about 30% for the Bloomberg U.S. Aggregate Bond Index. The fund entered 2022 with an 8.2-percentage-point financials overweight that the team had inched up by year-end even though it hurt. The team continues to like financials, noting banks' generally stout capital positions and alignment of their management incentives with high ratings given that banks consistently need to access debt markets.

The fund's securitized stake ended 2022 at 36.1% of assets, up from 26.7% a year prior. As repeated interest-rate hikes weighed on the mortgage market in 2022, the fund leaned in. The managers cut the portfolio's Treasury stake by about 9 percentage points to 22.9% and redeployed most of that money into securitized exposure, especially U.S. agency residential mortgage-backed securities, whose weighting increased 6.9 percentage points to 22.3% by year-end. That was then still about 5 percentage points lighter than the benchmark, though.

Throughout 2022, the fund stashed nearly one fourth of its assets in bonds with BBB ratings, roughly 10 to 11 percentage points heavier than the index. It added about 3 percentage points of exposure to AAA bonds, ending the year with a 12% stake, versus 3.2% for the index.

People High | Alec Lucas | 7 Feb 2023
Appreciation for how Baird Advisors' capable and collaborative investing culture pairs with the firm's simple but effective style earns the fund a People upgrade to High from Above Average.

Other top-tier firms may have bigger staffs and broader remits; Baird operates differently, and is excellent in its own right. Co-CIO Mary Ellen Stanek, winner of Morningstar's 2022 Outstanding Portfolio Manager award, and co-CIO Warren Pierson head this fund's veteran 10-person management team, whose members complement one another's strengths and stick to a straightforward, winning playbook.

Alongside Stanek and Pierson, Charles Groeschell and research director Jay Schwister set the tone here; each has about 40 to 45 years of industry experience. The other managers have a wider range of experience but collectively represent the next generation. Lead Jeffrey Schrom and comanagers Andrew O'Connell and Abhishek Pulakanti work as part of a seven-person credit team; Meghan Dean and Patrick Brown oversee a seven-person securitized team; and M. Sharon deGuzman guides Baird's seven-person portfolio construction and risk group.

Stability is a strength. Apart from two retirements in 2020 and 2021, respectively, no manager has left since this fund's 2000 inception. There have also been only two analyst departures since 2016, both for personal reasons.

Fund ownership stands out, too. Managers invest in all their strategies, with three owning more than $5 million each across the lineup.

Parent High | Alec Lucas | 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 | Alec Lucas | 7 Feb 2023
The fund has a strong long-term record. Since its late 2000 inception, its institutional shares' 4.39% annualized gain through January 2023 beat the Bloomberg U.S. Aggregate Bond Index by 46 basis points while placing in the top quintile out of roughly 65 distinct intermediate core bond Morningstar Category peers. Adjusted for volatility, results looked even better: the institutional shares' Sharpe ratio (a measure of return relative to standard deviation) was superior to the benchmark's and placed in the peer group's top decile.

Consistent outperformance has been a hallmark here. Over the past decade through 2022, the fund has beaten its index and distinct peer median in eight out of 10 calendar years. Versus the benchmark, the fund's best showing was in 2020, when its 8.63% return outpaced the index by 112 basis points. The fund didn't start that year well, though. Its typical Treasury underweight was a headwind in 2020's first-quarter, coronavirus-driven credit selloff. Increasing exposure to investment-grade credit after spreads widened helped for the year as whole, though, as did active positioning in that space.

The fund has on the whole beat inflation, as measured by the Consumer Price Index. From its 2000 inception through December 2022 (the most recent month for which CPI data is available), the fund grew each initial dollar invested into $2.53, ahead of the roughly $1.71 required to maintain purchasing power. The fund has struggled to edge inflation consistently, however, outpacing CPI's cumulative rise in only 75 out of 233 rolling three-year periods and none since the three years ended in February 2021. The fund, though, has fared better than the category norm, which only beat inflation in 45 of those rolling three-year periods.

Price | Alec Lucas | 7 Feb 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 Analyst Rating of Gold.

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International/Emerging Markets Securities Risk

Investing in international securities involves special additional risks. These risks include, but are not limited to, currency risk, political risk, and risk associated with varying accounting standards. Investing in emerging markets may accentuate these risks.

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Trading may be halted due to market conditions, impacting an investor's ability to sell a security.

Market Price Risk

The market price of securities traded on the secondary market is subject to the forces of supply and demand and thus independent of the NAV. This can result in the market price trading at a premium or discount to the NAV, which will affect an investor's value.

Market Risk

The market prices of securities can fluctuate as a result of several factors, such as security-specific factors or general investor sentiment. Therefore, investors should be aware of the prospect of market fluctuations and the impact it may have on the market price.

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Portfolios that invest a significant percentage of assets in a single issuer involve additional risks, including share price fluctuations, because of the increased concentration of investments.

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