Baird Core Plus Bond Inst BCOIX

A strong choice for the core-plus bond investor.

Morningstar's Take BCOIX

Morningstar Rating	★★★★
Morningstar Analyst Rating	Silver

Morningstar Pillars

Process	High
Performance	—
People	Above Average
Parent	Above Average
Price	—

Role In Portfolio

Core

Fund Performance

Year	Total Return (%)	+/- Category
YTD	-0.90	-0.39
2020	8.80	0.74
2019	10.11	1.17
2018	-0.51	0.10
2017	4.65	0.38

Data through 9-30-21

10-19-21 | by Gabriel Denis

An earlier iteration of this report published on Feb. 11, 2021, stated incorrectly that the strategy's high-yield debt limit was 25%. The correct limit is 20%, and the report has been adjusted to reflect the corrected figure. This change does not alter the strategy's ratings.

Baird Core Plus Bond's stalwart team, disciplined process, and low fees align to make the fund a dependable choice in the intermediate core-plus bond Morningstar Category. The strategy earns a Morningstar Analyst Rating of Silver across both share classes.

Lead manager and Baird CIO Mary Ellen Stanek heads a well-tenured, eight-person portfolio management team made up of four strategic leaders and four midlevel directors--most of this group has worked together since the strategy's inception in September 2000. Stanek's supporting cast continues to grow, boasting five structured and seven corporate credit analysts at the end of 2020. Although not as grand as some of the firm's largest competitors, the group is deeply collaborative and sticks to investments it can research thoroughly and confidently.

Stanek and her team use a tried-and-true valuation-driven process to outpace the Bloomberg Barclays U.S. Universal Index. A mixture of investment-grade corporates, high-quality securitized credit, and government bonds form the core of the portfolio, with a smattering of high yield (between 2% and 7% over the decade ended December 2020) and dollar-denominated emerging-markets corporates (less than 2% as of December 2020). When the team ventures into below-investment-grade fare, it prefers to hold a diversified set of well-trafficked names rather than concentrate in a few positions. The team matches the fund's duration to that of the index, sets strict limits on position sizing, and avoids derivatives, leverage, and nondollar bonds. These constraints allow management to focus on its strengths: security selection and sector rotation.

The strategy's low fees and careful risk controls have helped it outperform over its two-decade lifespan. Its 5.9% annualized return from its October 2000 inception through January 2021 outpaced both its index and 80% of its peers, and its risk-adjusted return (measured by Sharpe ratio) landed in the top decile of its cohort.

Process Pillar High | Gabriel Denis 02/11/2021

Mary Ellen Stanek and crew have maintained the same transparent, risk-aware combination of security selection and sector rotation to outrun their Bloomberg Barclays U.S. Universal Index benchmark for over two decades. Their thoughtful and straightforward approach earns a High Process Pillar rating.

The strategy has access to the same sectors as its index, a mix of corporate, securitized, and government bonds. Yet unlike many rivals in the intermediate core-plus bond Morningstar Category, it treads lightly in lower-quality bonds and forgoes leverage, derivatives, and non-dollar-denominated debt. Instead, the team hunts for investments that it believes offer strong fundamental features and attractive relative value and that fit within its broader macroeconomic views. They keep the strategy's duration neutral to that of the index to limit rate-driven volatility and facilitate the best expression of its credit opinions.

The team's size and resources look trim compared with some rivals, but this group limits its pickings to sectors and bonds within its wheelhouse. To date, the managers have avoided subordinated mortgage- and asset-backed fare, emerging-markets sovereigns, and non-dollar-denominated bonds across their portfolios. Design features such as diversification guidelines and rules on position-sizing function as additional risk controls.

A persistent overweighting to corporate bonds, averaging half of the portfolio over the trailing 10 years ended December 2020, distinguishes the strategy from its benchmark. At the end of 2020, the strategy's corporate credit stake grew to 54% from 49% a year earlier. The team maintained a heavy overweight to financials (21%) relative to their Universal bogy (10%), citing strong balance sheets among several major banks as making the sector look attractive. Beyond this sector, the team sought to add exposure to well-trafficked, high-quality names such as Verizon VZ and CVS Health CVS when spreads widened following the March 2020 sell-off.

While investment-grade credit forms the core of the portfolio, it may also hold up to 20% in below-investment-grade debt. While it has not come close to breaching that limit over the period (it averaged 8% over the decade ended December 2020), this stake grew 4% from 3% a year earlier. The vast majority of this stake comprised high-yield corporates, with the team adding small stakes to certain names like United Rentals URI where valuations looked attractive. Within securitized fare, a much smaller portion of the total high-yield stake (less than 1%) included exposure to legacy nonagency mortgages.

Performance Pillar | Gabriel Denis 02/11/2021
This strategy's record is long and consistent. Over the core team's tenure from October 2000 through Jan. 31, 2021, its 5.9% annualized return landed in the best quintile of distinct rivals in the intermediate core-plus bond Morningstar Category and over 70 basis points ahead of its Bloomberg Barclays U.S. Universal Index. Its risk-adjusted return, as measured by the Sharpe ratio, landed in the top quintile of its distinct peers. Shorter trailing periods, such as the three- or five-year marks, saw similar results.

Relative to its Universal bogy, the strategy's overweighting in corporate bonds has contributed to outperformance during credit rallies and minor trouble during credit sell-offs. Yet the team's judicious attention to valuations and risk-mindedness have helped it surpass less cautious rivals over the long haul. During the most painful period of 2008, the strategy's 4% tumble from September through November lagged its index but outperformed nearly 70% of its rivals. Most subsequent credit sell-offs, such as the commodity-related sell-off from June 2015 through February 2016 or the 2018 fourth-quarter broad market sell-off, see a similar pattern of falling behind the index but comfortably leading its typical peer. Most recently, the fund outperformed around 60% of its rivals during the coronavirus-related sell-off from Feb. 20 through March 23, 2020.

People Pillar Above Average | Gabriel Denis 02/11/2021
While lacking the goliath analyst benches of some of the larger players in the fixed-income space, the nimble team helming this strategy benefits from seasoned leadership and a tight-knit, collaborative investment culture. It earns an Above Average People Pillar rating.

Baird Advisors CIO Mary Ellen Stanek heads a well-tenured, eight-person portfolio management team made up of four members of the strategic leadership team and four midlevel leaders. Five of these eight have been listed on the strategy since its September 2000 inception date, with a further three added over 2019. Her supporting roster of analysts, including five structured, seven credit, and four risk analysts, has continued to grow, with three joining the firm over the course of 2020.

The team's strengths lie in its experienced leadership bench, cohesive culture, and mindfulness about its limitations. This team does not pursue highly credit-sensitive or esoteric investments that would require resources beyond those that currently exist to support the strategies. Stanek has also been proactive in expanding both the team's roster and resources. While many of the senior leaders on this bench are far along in their careers, the naming of several midlevel leaders to the strategy suggests they are well-positioned to take the reins in the future should any top-level changes occur.

Parent Pillar Above Average | Gabriel Denis 03/31/2020
Baird's strength in its large fixed-income business and investor-friendly stewardship merit an Above Average Parent rating.

Under the leadership of longtime CIO Mary Ellen Stanek, the firm's taxable-bond funds continue to impress. Boasting low fees, a well-resourced team, and risk-aware investment processes, they constitute over 90% of the firm's assets under management, expanding from $37 billion in 2016 to nearly $88 billion at the end of 2019. This growth bears monitoring, but the team has shown prudence in adding personnel and operational resources to manage this burgeoning load. In recent years, the group has also focused on building out its municipal-bond effort, adding several key members to the team and launching two new municipal strategies in mid-2019. Although the firm's equity enterprise is smaller, it too benefits from tenured managers and attractive fees.

The firm's private wealth management arm has also grown precipitously in recent years, most recently through the acquisition of Louisville, Kentucky-based Hilliard Lyons in 2019. When framing the growth of this organization, Baird emphasized that Hilliard Lyons' advisors fit the cultural profile of its organization. This cultural fit is important: Turnover among the firm's analyst staff has historically been low, and around two thirds of employees owned stock in the firm at the end of 2019.

Price Pillar | Gabriel Denis 02/11/2021
It's critical to evaluate expenses, as they come directly out of returns. The share class on this report levies a fee that ranks in its Morningstar category's cheapest quintile. Based on our assessment of the fund's People, Process and Parent pillars in the context of these fees, we think this share class will be able to deliver positive alpha relative to the category benchmark index, explaining its Morningstar Analyst Rating of Silver.