Q2 2022 Commentary and Market Outlook

Baird Equity Opportunity Fund

Baird Equity Asset Management

PORTFOLIO COMMENTARY

Fellow shareholders,

Equities fell sharply in the second quarter, burdened by accelerating inflation, tightening monetary policy, and growing recession fears. After declining 7.5% in the first quarter, the Russell 2000 Index dropped another 17.2% during the most recent three months, bringing its year-to-date loss to 23.4%. The Baird Equity Opportunity Fund performed relatively well, declining 13.5% net in Q2 and 17.2% year-to-date, outperforming the Russell 2000 by 370bps for the quarter and 620bps thus far in 2022.*

All sectors, styles, and market caps lost ground in Q2. Energy was the standout gainer on a year-to-date basis, while secular growth sectors such as Consumer Discretionary, Information Technology, and Communication Services posted the heftiest losses. Small cap stocks fared modestly worse than larger cap stocks in both Q2 and year-to-date. Value stocks outperformed growth again in Q2, and at mid-year the Russell 2000 Value Index was outpacing the Russell 2000 Growth Index by over 1,200 basis points. Losses were not reserved for equities alone, as bonds posted quarterly losses in two consecutive quarters and the two most popular cryptocurrencies, Bitcoin and Ethereum, sank 57% and 68%, respectively, during Q2 alone. Volatility remained elevated; the S&P 500 has risen or fallen 1% or more in over half the trading days thus far in 2022.

The Fund had a diverse list of top contributors during the second quarter, including food distributor Chefs' Warehouse (CHEF), payment processor EVO Payments (EVOP), and oil service company NexTier Oilfield Solutions (NEX). Fortunes have improved for CHEF this year, following two difficult years of weaker fundamentals that were highly impacted by Covid. With most restaurants now fully reopened, CHEF is benefiting from significant revenue tailwinds as volumes build and recent acquisitions contribute. In addition, strengthening profit margins are driving rapidly expanding profits, and the stock has performed very well as a result.

With beachhead positions in attractive foreign payments markets such as Mexico and Poland, EVO Payments continues to enjoy attractive secular growth as those economies embrace credit and debit cards. The business is highly profitable, and we believe well managed while the stock is reasonably priced based on our analysis. Recent results have been strong, and the stock has responded nicely. NexTier is a play on both increased energy production and pricing improvements after a long bear market in oil service industries, driving rapid profitability expansion. The stock benefited from good energy stock performance in general, and strong company-specific results in the first half of the year.

Key detractors during the quarter included optical systems maker Infinera (INFN), video-game maker Zynga (ZNGA), and database operator Verisk (VRSK). Infinera's business is enjoying robust demand, but like others, is struggling to acquire critical components, restraining the revenue and margin upside we have been expecting. We remain patient and believe a payoff will come, though certainly later than we would have liked. Zynga was recently acquired by Take-Two Interactive (TTWO); the underperformance during the quarter related to the fact that it was largely a stock transaction, and TTWO languished on mediocre results. The merger has since closed, and we currently hold neither ZNGA nor TTWO. Verisk's weakness seems unrelated to its fundamentals, as the company continues to perform well. We think there are visible catalysts on the horizon, including the potential split of its insurance database business from its energy-related databases.

Our big picture view is that markets will likely remain volatile and challenging for two main reasons. First, we anticipate monetary policy to remain restrictive as the Federal Reserve seeks to combat inflation. We presume that interest rates will rise further, and, via quantitative tightening, the central bank will withdraw liquidity from the financial system, shrinking its bloated balance sheet. This should ripple through financial markets much as it did as interest rates were plunging and the Fed's balance sheet was exploding higher. Second, for the first time in nearly a decade, we anticipate that a broad swath of companies will experience fundamental deterioration in the coming quarters. Headwinds include slowing revenue growth as consumer demand softens from lack of stimulus and price inflation along with an array of supply-side constraints. Moreover, profit margins will come under pressure from soaring input costs, rising interest rates, and unfavorable currency movements.

***Performance data represents past performance and does not guarantee future results. The investment return and principal value of the investment will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Current performance data may be lower or higher than the data quoted. For performance data as of the most recent month-end, please visit bairdfunds.com**

CHEF had a 6.93%, EVOP 7.99%, NEX 2.24%, INFN 3.82%, ZNGA 0.0%, and VRSK 4.34% weighting in the Equity Opportunity Fund as of 6/30/2022.

Beyond these fundamental issues, tighter financial conditions have begun to cleanse many of the “bad behaviors” we have witnessed in prior years. Examples include steep declines in de-SPAC prices, waterfall events in select tertiary cryptocurrencies, deflating valuations of unprofitable durable growth companies, and significant losses across many so-called meme stocks. Still, several bad behaviors remain unaddressed, including seemingly daily rip-offs, hacks, and frauds within the cryptocurrency ecosystem and the abundance of highly valued non-earners, which still comprise over 40% of the Russell 2000 Index.

We recognize and appreciate variant views of the forward investing landscape. The most prevalent seems to be that the Federal Reserve will, once again, backtrack on monetary tightening, either because they cannot take the pain from asset price deflation or because an imminent recession will curb inflation and provide room to ease. It is undeniable that the Fed has steered toward the “easier” route for monetary conditions at nearly every opportunity over the past decade - the most recent example being the “Powell Pivot” in early 2019 following a bruising fourth quarter of 2018 in the equity markets.

A near-term pivot is not our base case for two main reasons. First, the Consumer Price Index rose a mere 1.9% in December 2018, to return to that instance, and reported inflation remained well within the Fed’s target range over the prior decade more broadly. Low inflation made it comparatively easy to maintain loose monetary policy, essentially having their cake and eating it too by stoking asset price inflation without attendant consumer price inflation. With the CPI currently running over 8%, the Fed does not have that luxury today. Second, the size of the Fed’s balance sheet was “only” $4 trillion exiting 2018; today it sits just shy of $9 trillion. It seems clear that the Fed needs – and wants – to get control of the bloat. In one of Chairman Powell’s first FOMC meetings in October 2012, when arguing against more quantitative easing at that time, he stated: “My concern is the problems of exiting from a near $4 trillion balance sheet…it just seems to me that we seem to be way too confident that exit can be managed smoothly. Markets can be much more dynamic than we appear to think.” We think these words are worth heeding, and we can only assume that with the Fed’s balance sheet having doubled again, the exit will be considerably more challenging.

Looking further out, we see potential for greater stability in the years ahead. If the Federal Reserve remains steadfast in its current tighter monetary policy, interest rates will rise but inflation should subside from current levels. The means to that end might cause further volatility and displease some investors, but we would view a move toward normalization positively, especially if it deals a knockout blow to speculative remnants of the long zero interest rate policy era. We also expect a less rosy view of analyst earnings estimates for the remainder of this year and next, but once that occurs, it could reduce the risk of wading into certain situations, especially if estimate cuts lead to further stock price declines and more attractive valuations.

Greenhouse feels well-prepared for a new environment that rewards experience and sound judgment, bottom-up research, and domain expertise. Our process is detail-oriented and rooted in a risk-reward framework, which is well-suited for a time when valuations better reflect fundamentals instead of artificially depressed discount rates. The portfolio is concentrated in our highest conviction names and the idiosyncratic nature of our holdings should help suppress correlation to the broader markets. Maintaining due respect for the risks we see, we are prepared to respond quickly as favorable risk-reward opportunities arise.

The first half of 2022 has been a very difficult period for financial markets. Within the constraints of a long only strategy, we have leaned on our discipline, experience, and tested investment process to modestly mitigate losses. We look forward to updating you on our progress and perspectives in early October.

Respectfully,

Joe Milano

Baird Equity Opportunity Fund (Q2 2022)

PERFORMANCE

Periods Ending June 30, 2022* (%)	Total Return (%)		Average Annual Total Returns (%)			
	QTR	YTD	1 Year	3 Year	5 Year	Since Inception (04/30/2012)
Baird Equity Opportunity Fund – Net Institutional Class (BSVIX)	-13.52	-17.18	-11.98	2.13	2.83	6.44
Baird Equity Opportunity Fund – Net Investor Class (BSVSX)	-13.56	-17.28	-12.13	1.88	2.58	6.18
Russell 2000 Index®	-17.20	-23.43	-25.20	4.21	5.17	8.98
Russell 2000 Value Index®	-15.28	-17.31	-16.28	6.18	4.89	8.73

TOP & BOTTOM CONTRIBUTORS

Top 5 Portfolio Contributors	Avg. Weight	Contribution
Chef's Warehouse (CHEF)	5.29	0.96
EVO Payments (EVOP)	6.68	0.18
Castle Biosciences (CSTL)	0.49	0.06
SPDR S&P Oil & Gas Exploration & Prodution ETF (XOP)	0.30	0.05
Allegheny Technologies (ATI)	0.07	0.05

Bottom 5 Portfolio Contributors	Avg. Weight	Contribution
Infinera Corp. (INFN)	4.05	-1.82
Zynga Inc. (ZNGA)	2.79	-0.90
Verisk Analytics (VRSK)	4.15	-0.78
Vista Outdoor (VSTO)	3.06	-0.72
Ingersoll Rand (IR)	3.83	-0.68

Investment Professional	Years of Experience	Team Since	Coverage Responsibility
Joe Milano, CFA Portfolio Manager	25	2013	Generalist
Chip Morris, CFA Analyst	35	2014	Technology
Scott Barry Analyst	25	2014	Consumer Discretionary & Staples
Ben Landy Analyst	13	2014	Industrials & Materials
Scott Mafale Analyst	16	2021	Healthcare

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This commentary represents portfolio management views and fund holdings as of 06/30/22. Those views and fund holdings are subject to change without notice. The performance of any single fund holding is no indication of the performance of other holdings of the Baird Equity Opportunity Fund. Past performance is no guarantee of future results.

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. Past performance does not guarantee future results.

Prior to December 12, 2021, the fund was managed in accordance with a different investment strategy. The Subadvisor became the Fund's subadvisor effective December 12, 2021. The performance results shown are from periods during which the Fund was managed by the Advisor prior to the retention of a Subadvisor.

As a non-diversified fund, the fund may invest a larger percentage of its assets in a smaller number of companies compared to a diversified fund, which increases risk and volatility because each investment has a greater effect on the overall performance. The fund focuses on small- and mid-cap stocks and therefore the performance of the fund may be more volatile, less liquid and more likely to be adversely affected by poor economic or market conditions than investments in larger companies. The fund may invest up to 15% of its total assets in the equity securities of foreign companies. Foreign investments involve additional risks such as currency rate fluctuations, the potential for political and economic instability, and different and sometimes less strict financial reporting standards and regulation.

The Net Expense Ratio is the Gross Expense Ratio minus any reimbursement from the advisor. The advisor has contractually agreed to waive its fees and/or reimburse expenses at least through April 30, 2025, to the extent necessary to ensure that the total operating expenses do not exceed 1.50% of the Investor Class's average daily net assets and 1.25% of the Institutional Class's average daily net assets.

The Russell 2000 is the most widely quoted measure of the overall performance of small-cap to mid-cap stocks. It represents approximately 10% of the total Russell 3000 market capitalization. It is made up of the bottom two-thirds in company size of the Russell 3000 index. The Russell 2000 Value Index measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecast growth values. Indices are unmanaged and are not available for direct investment. Time periods greater than one year are annualized.

Baird Funds are offered through Robert W. Baird & Co., a registered broker/dealer, member NYSE and SIPC. Robert W. Baird & Co. also serves as investment advisor for the Fund and receives compensation for these services as disclosed in the current prospectus.

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