Baird Mid Cap Growth Equity

Q3 2021 COMMENTARY

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Baird Equity Asset Management

MARKET UPDATE

Market strength during the quarter's first two months gave way to growing inflation concerns and a rise in long-term rates, albeit a modest increase in absolute terms. The abundance of positive economic surprises reported as activity rebounded from pandemic lows grew less frequent through the summer as a third wave of COVID-19 cases weighed on overall activity levels. Rising consumer net worth and ongoing improvements in the employment picture supported strong demand in most segments of the economy, only to be offset by a global supply chain that struggled to keep up. The net of it all was a flat to slightly negative quarter for equity returns.

PORTFOLIO COMMENTARY

The Baird Mid Cap Growth portfolios rose 4.7% in the third quarter, gross of fees, outpacing the -0.8% decline in our primary benchmark, the Russell MidCap® Growth Index. Nearly all portfolio sectors produced relative outperformance. Quality factors, as defined by metrics such as high profitability, low debt levels, and strong returns, meaningfully outperformed lower quality for the quarter. Most notably, unprofitable stocks which comprise approximately 25% of the benchmark, declined nearly 6% in the quarter compared to a 2% rise in companies producing profits. Our portfolio should perform well when such factors are favorable. Thus, the benefits of a style tailwind when combined with strong individual stock picking resulted in material outperformance for the quarter. There's no telling whether quality characteristics will continue to drive equity returns going forward, but we believe our strategy is well positioned should they persist. More in-depth comments about sector performance follow.

The portfolio's healthcare stocks were the leading contributor to overall portfolio outperformance. Good quarterly earnings results and positive stock reactions from several holdings drove returns in the quarter, including Repligen, DexCom, Catalent, and ICON. These stocks all advanced more than 20% in a tougher investment environment. Sector relative performance also continued to benefit from weakness in biotechnology stocks, as many in the industry experienced further declines. Adjustments we made in the quarter included trims which captured a portion of the gains in Repligen and long-time holding IDEXX Labs, while upping our exposure to Align where we continue to see opportunity for strong growth.

The return factors discussed above provided a very supportive performance backdrop for the technology sector. We've noted in the past that the sector is filled with many interesting and fast-growing companies, but nearly half don't currently produce profits. The aggressive spending by many companies intended to penetrate markets quickly isn't without merit, but we are reticent to assign success to so many companies without sustainable proof on the bottom line. Thus, our focus remains on businesses generating high returns and profitability. Strong relative performance was driven by a handful of holdings that advanced sharply versus choppiness in most segments of the sector. Monolithic Power was a standout, lifted by solid quarterly results and a bullish outlook, and it was joined by service providers EPAM and Globant as well as Lattice Semiconductor and Paycom Software. Regarding portfolio changes, we sold Aspen Technologies due to uneven business execution, and trimmed EPAM to harvest some gains after a strong run. We used the proceeds to continue filling newer technology positions in Cadence and Globant and to purchase a new position in Match Group, the dominant, multi-branded online dating platform. Dating continues to migrate online, and we believe Match is in the early innings of monetizing its brands, including Tinder, Hinge and recently acquired Hyperconnect. Shorter-term, we believe Match should benefit from the reopening of economies and increased socialization coming out of the pandemic.

The smaller weighted sectors - consumer staples, energy, materials, real estate, and telecommunications together delivered solid outperformance. We currently have no exposure in the energy and telecommunications sectors, and declines there helped performance. Within telecommunications the benchmark's two cable stocks, Altice and Cable One, sold off following

TENURED MID CAP GROWTH INVESTMENT TEAM

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Research Analyst

- Team members have equity ownership in Baird*
- Deep sector expertise
- Average years of experience: 19 years

Altice's commentary regarding lower subscriber additions; large benchmark weight Roku also underperformed. Our one real estate holding, CoStar Group, advanced, which proved helpful given the negative benchmark sector return. In materials, RBC Bearings popped on its announced agreement to acquire ABB's DODGE Mechanical Power Transmission business. Consumer staples was the only negative contributor of the group, as our holding Lamb Weston declined. The company has a better top-line outlook than other staples businesses, but like most in the sector, supply chain and cost-related challenges are pressuring near term fundamentals.

The financial services sector outperformed as Pinnacle Financial, a southeast-focused banking company, and index provider MSCI pushed higher. Positive equity markets this year and prospects for rising rates in response to more inflation have helped buoy traditional areas of the sector. With prospects for a pick-up in lending activity, we moved additional capital to Pinnacle, using proceeds from a trim of MSCI.

Relative performance in the industrial sector was rather muted overall, tracking the slight negative return posted by the benchmark. It's no surprise that the sector is ground zero for the debate on the direction of the economy given the cyclical nature of many of the industry groups. Thus, with concerns increasing that the economy was stagnating somewhat amid global supply chain problems and rising input costs, the investment environment grew more difficult. Even so, the return spread between portfolio winners and losers in the sector was rather tight. We remain overweight based on the belief that supply chain challenges will gradually ease and that strong demand will persist, affording enough pricing power to deal with cost increases. Changes here were quite modest with a trim of Keysight and Generac after meaningful strength and an add to newer holding Advanced Drainage Systems, which had pulled back.

The portfolio's mix of consumer discretionary companies outperformed nicely as holdings across several industries performed well. Our retail holdings accounted for a good portion of the value added as Floor & Décor, Williams Sonoma, and Tractor Supply stood out on the plus side. Chipotle continued to perform well as demand fundamentals remain healthy. One pocket of weakness was the electronic entertainment industry which includes Take-Two Interactive. A delayed game release schedule for the company and some unwind of strong gaming activity during the pandemic created challenges and as a result we decided to move on. A portion of the sale proceeds were added to Williams Sonoma where we envision strong spending on home furnishings to persist.

OUTLOOK

The basic economic equation typically comes to us in the stated form of "supply and demand"; however, current dynamics would have us reverse the order as we face a story of demand trying to find supply. The visual of dozens of large container ships off the coast of California has become all too familiar as have the stories of businesses and consumers unable to obtain parts or product. The resulting pick-up in inflation is now apparent at most every turn – food, gas, homes, wages etc., and the debate appears much less about transitory and much more about magnitude. In our view, the key for corporate profits and markets will be the easing of these supply pressures and the sustainability of demand. With consumer net worth at record levels and wages rising, drivers appear in place to sustain demand and absorb higher prices, and while the Federal Reserve will likely taper bond buying activity during the fourth quarter, monetary policy remains accommodative. There's no shortage of macro data points to discuss, but our focus remains on investing in well-positioned businesses with strong management teams, and conservative balance sheets, who we believe can better navigate this most unusual environment.

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

Mid Cap Growth Investment Team

Investment Professional	Years of Experience	Years with Baird	Coverage Responsibility	Educational Background
Chuck Severson, CFA Senior Portfolio Manager	34	34	Generalist	MS – Finance - The Applied Security Analysis Program (University of Wisconsin – Madison) BBA – Accounting and Finance (UW–Madison)
Ken Hemauer, CFA Co-Senior Portfolio Manager	27	27	Financial Services	MS – Finance - The Applied Security Analysis Program (University of Wisconsin – Madison) BBA – Finance (UW–Madison)
Jonathan Good Senior Research Analyst	21	15	Healthcare	MBA – (Northwestern University – Kellogg) BS – Applied and Biomedical Sciences (Pennsylvania)
Corbin Weyer, CFA, CPA Director of Research & Senior Research Analyst	11	11	Consumer Discretionary & Staples	BSBA – Finance & Accounting (Marquette University)
Doug Guffy Senior Research Analyst	38	17	Energy, Industrials & Materials	MBA – Finance (Ball State University) BA – Economics & Government (Anderson University)
Karan Saberwal Senior Research Analyst	5	3	Information Technology	MBA (Northwestern University – Kellogg) BE – Bachelor of Engineering (Army Institute of Technology, University of Pune)
Josh Heinen Research Analyst	<1	<1	Generalist	MS – Finance - The Applied Security Analysis Program (University of Wisconsin – Madison) BBA – Finance (UW–Madison)

Mid Cap Growth Top & Bottom Contributors

Top 5 Portfolio Contributors			Bottom 5 Portfolio Contributors		
Security	**Avg. Weight**	**Contribution**	**Security**	**Avg. Weight**	**Contribution**
Repligen Corporation (RGEN)	2.30	0.85	Lamb Weston Holdings, Inc. (LW)	1.62	-0.46
Paycom Software, Inc. (PAYC)	2.39	0.71	PTC Inc. (PTC)	1.62	-0.25
Monolithic Power Systems (MPWR)	2.42	0.61	Jazz Pharmaceuticals (JAZZ)	0.80	-0.25
DexCom, Inc (DXCM)	2.47	0.59	NCR Corporation (NCR)	1.37	-0.22
ICON Plc (ICLR)	2.04	0.47	Five Below, Inc. (FIVE)	2.55	-0.18

Mid Cap Growth Average Annual Returns (%)*

	QTD[1]	YTD[1]	1 Year	3 Years	5 Years	10 Years	Since Inception (06/30/93)
Composite – Gross	4.69	14.80	36.60	21.99	22.35	18.33	13.40
Composite – Net	4.52	14.21	35.67	21.14	21.49	17.50	12.76
Russell MidCap Growth Index	-0.76	9.60	30.45	19.14	19.27	17.54	11.15

*09/30/2021 composite returns are preliminary.
[1] Returns for periods of less than one year are not annualized.

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.

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.

This commentary represents portfolio management views and portfolio holdings as of 9/30/21. 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.

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