

MARKET UPDATE

Continuing a trend seen year-to-date, the Russell 2500 Growth Index alternated each month between negative and positive returns during the third quarter of 2021. 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 negative quarter for equity returns.

PORTFOLIO COMMENTARY

The Baird Small/Mid Cap Growth strategy returned 1.4% in the third quarter of 2021, gross of fees, generating roughly 490 basis points of relative outperformance versus the Russell 2500 Growth benchmark return of -3.5%. Overall, this quarter represented the largest quarterly relative outperformance since the strategy inception six years ago. This was a function of both good stock picking, as well as favorable style tailwinds. Factors that we consider “quality” such as profitability, return on invested capital, and low leverage all outperformed in the quarter. For example, unprofitable stocks in the Russell 2500 Growth Index returned -8% in the quarter, compared to roughly flat performance for profitable companies. On average, larger companies performed better than smaller, and lower valuations outperformed higher valuations. Trading activity was minimal throughout most of the quarter, with the exception of some modest changes near the end of the quarter which we discuss in greater detail below.

Performance in the third quarter was broad-based, as nearly all sectors were positive relative contributors. The four strongest sectors (also the largest by weight) were healthcare, consumer discretionary, technology, and industrials. Healthcare stocks were volatile around the emergence of the COVID delta-variant, but we believe stock performance was more dependent on positive fundamental earnings updates for holdings, including Repligen, Icon, Catalent, and Inspire Medical. On the consumer side, relative third quarter outperformance was due to continued positive consumer spending and strong continued trends on almost anything related to housing. Holdings that benefited included SiteOne, Floor and Décor, Crocs, and Williams Sonoma. In technology, our portfolio benefited from strong earnings from several holdings outside of software, such as semiconductor companies Monolithic Power and Lattice Semiconductor. We continue to see very strong business spending on IT-services, and we continue to benefit from owning both Endava and Globant. Finally, our industrials performance was driven by the secular growth portion of the portfolio, as many cyclical stocks declined in the quarter. Our strongest performers in the quarter included Paylocity (we believe more of a technology company), and Kornit Digital.

Fortunately, in the third quarter while the relative underweight to real estate and zero exposure to utilities were only a slight relative detractor from performance, there were no sectors with notable relative underperformance. However, we did have a few holdings that detracted from performance. As not all healthcare holdings benefited from rising COVID cases, we trimmed our position in LHC group after a disappointing update post second quarter results. We also sold our position in Innovage, which is seeing slowing enrollment growth in some key facilities due to regulatory audits from the government. In technology, a few holdings reported quarterly earnings that were viewed negatively, such as Zendesk, PTC, and Q2 Holdings. MasTec also was a detractor from performance in the quarter, after being one of our stronger “cyclical” performers through the first half of 2021.

As we head into the final quarter of 2021, we are cognizant of strong relative performance, not only year-to-date, but over the last several years. We added several new ideas into the portfolio, either to replace ideas where we were lacking conviction in the investment thesis, or to take some profits in stocks that have worked in our favor. Given the underperformance in cyclical

TENURED SMALL/MID CAP GROWTH INVESTMENT TEAM

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Mid Cap Growth Senior PM

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

stocks in the third quarter, we added some exposure in this area. We are now equal-weight energy (roughly 3% of the portfolio) after purchasing Diamondback, Champion, and Enphase Energy. We also added more cyclical exposure in the industrials sector by adding Knight Transportation and Oshkosh Truck and selling Lennox and Cognex. Other new ideas added near the end of the quarter included Bio-technique, and Paycor. Finally, we decided to exit positions in Staar Surgical (profit taking in front of an FDA event in the fourth quarter), Upland (thesis no longer valid), and Zendesk (disappointing growth outlook).

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 Small/Mid Cap Growth Strategy.

Small/Mid Cap Growth Investment Team

| Investment Professional | Years of Experience | Years with Baird | Coverage Responsibility | Educational Background |
|---|---------------------|------------------|----------------------------------|---|
| Jonathan Good Portfolio Manager | 21 | 15 | Healthcare | MBA – (Northwestern University – Kellogg) BS – Applied and Biomedical Sciences (Pennsylvania) |
| Ken Hemauer, CFA Senior Research Analyst | 27 | 27 | Financial Services | MS – Finance - The Applied Security Analysis Program (University of Wisconsin – Madison) BBA – Finance (UW–Madison) |
| 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) |
| Chuck Severson, CFA Mid Cap Growth PM | 34 | 34 | Generalist | MS – Finance - The Applied Security Analysis Program (University of Wisconsin – Madison) BBA – Accounting and Finance (UW–Madison) |

Small/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) | 2.55 | 0.88 | MasTec, Inc. (MTZ) | 2.02 | -0.42 |
| Paylocity Holding Corp. (PCTY) | 2.14 | 0.79 | Lamb Weston Holdings, Inc. (LW) | 1.47 | -0.41 |
| Monolithic Power Systems (MPWR) | 2.66 | 0.66 | LHC Group, Inc. (LHCG) | 1.76 | -0.37 |
| ICON Plc (ICLR) | 1.96 | 0.45 | InnovAge Holding Corp. (INNV) | 0.44 | -0.36 |
| Globant SA (GLOB) | 1.81 | 0.42 | Jazz Pharmaceuticals (JAZZ) | 1.07 | -0.33 |

Small/Mid Cap Growth Average Annual Returns (%)*

| | QTD ¹ | YTD ¹ | 1 Year | 3 Years | 5 Years | Since Inception (9/30/15) |
|---------------------------|------------------|------------------|--------|---------|---------|---------------------------|
| Composite – Gross | 1.36 | 13.48 | 34.93 | 22.58 | 24.42 | 22.05 |
| Composite – Net | 1.14 | 12.78 | 33.81 | 21.51 | 23.41 | 21.05 |
| Russell 2500 Growth Index | -3.53 | 4.84 | 31.98 | 16.01 | 18.21 | 16.98 |

*09/30/2021 composite returns are preliminary.

¹Returns 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 2500[®] Growth Index measures the performance of those Russell 2500 companies with above average price-to-book ratios and higher forecasted growth values. When sorted by market cap, the Russell 2500[®] Index consists of all of the companies in the Russell 3000[®] Index, except for the 500 largest companies by market capitalization in that index. 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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