

During the third quarter, equity markets witnessed a sustained rotation from low quality to high quality stocks. This is a bullish indicator for us and bodes well for the coming years. We believe we are in the early innings of a rotation back to high quality, which in previous market cycles, has been a multi-year phenomenon. How quickly has our underperformance been recouped following a period of strong low-quality stock returns? During the past 2 cycles (2010 and 2016) we have recovered 75% of the previous year's underperformance in 12 months, as part of a multi-year cycle of cumulative outperformance versus the benchmark. High quality value stocks appear to have ample room to run as the 12-month return for low return-on-equity stocks is still well ahead of that for high return-on-equity stocks, despite the later trading at an extreme 14-times sales¹. Higher interest rates and a steeper yield curve are the enemies of lofty valuations and could crush these high multiple stocks if rates continue to rise. As a preview of what may be to come, value outperformed growth across small and small/mid-size indices during the third quarter.

In last quarter's commentary, we highlighted three reasons why small cap quality value stocks are set to outperform. They bear repeating as we believe market history will repeat itself and we are at an inflection point which offers opportunity:

1. We are moving from economic recovery to expansion. During this mid-cycle period, high beta/low quality outperformance is historically replaced by outperformance of high-quality stocks. This transition is a process that can take several months, but low quality continues to show signs of topping.
2. Low quality stocks as measured by return on equity (ROE) trade at extreme levels last seen in 2000.
3. Historically during periods of inflation, high quality value stocks have beaten the market. When inflation rises between 2 and 4%, the lowest ROE stocks are in the red and the highest ROE stocks have produced low-teen total returns².

BAIRD SMALL CAP VALUE

For the quarter, the Baird Small Cap Value Portfolio outperformed the benchmark, providing a gross return of -0.95% versus the Russell 2000 Value gross return of -2.98%. Since inception (3/1/05), the Baird Small Cap Value Portfolio has provided a gross annual return of 8.67% vs 7.99% for the Russell 2000 Value.

Sector attribution again showed superior security selection across most economic sectors with Industrials, Consumer Discretionary, Healthcare, and Consumer Staples holdings all meaningfully outperforming the Russell 2000 Value sector performance. Within Industrials, transportation-related holdings Knight-Swift and Air Transport Services Group were among the strong performers. Long-time winners Tractor Supply and William-Sonoma led Consumer Discretionary gains on the heels of strong earnings and positive guidance. JOANN, however, disappointed as sales fell short in the summer months

^{1,2}Source: Jefferies

SMALL & SMALL/MID VALUE EQUITY INVESTMENT TEAM

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PHILOSOPHY & PROCESS

- The portfolio is grounded in the belief that value and growth investing are not mutually exclusive.
- Emphasis on companies likely to exceed "street" expectations but trade at a discount to our in-house calculation of fair value.

PORTFOLIO CONSTRUCTION

- Concentrated portfolio of 40-50 stocks
- Top holdings generally limited to 5% at cost, 8% at market
- Sectors capped at 30% excluding financials
- Buy and hold approach

before the resurgence of Covid cases. Other standout individual winners included Axos Financial, First American Financial and Cabot Oil and Gas.

Energy was the only meaningful sector detractor for the period (-34 basis points) as the strength in exploration and production stocks was offset by laggards in energy equipment and services such as Solaris and Select Energy. Immersion declined during the quarter on soft gaming revenue as their largest customer, Sony, shipped less consoles due to supply chain issues. With nearly \$4 per share of net cash and projected earnings of \$0.89 next year, the stock appears extremely undervalued. Despite exceptional earnings reports, Haverty Furniture and Cerence saw their stocks correct from recent moves higher.

During the quarter, we took advantage of strength in technology to sell Knowles and NCR. Our Real Estate Investment Trust position was bolstered by the addition of Alpine Income Property Trust, Plymouth Industrial REIT and additions to several existing positions. Within Financials, we sold First American Financial Peoples Bancorp in favor of NMI Holdings and Argo Group International. A number of existing holdings were reduced or added to opportunistically during the period.

BAIRD SMALL/MID CAP VALUE

For the quarter, the Baird Small/Mid Cap Value Portfolio outperformed the benchmark, providing a gross total return of 0.04% versus a gross total return of -2.07% for the Russell 2500 Value. Since inception (1/1/00), the Baird Small/Mid Cap Portfolio has provided a gross annual return of 10.85% vs 10.05% for the Russell 2500 Value.

Sector attribution again showed superior security selection across most economic sectors with Industrials, Consumer Discretionary, Financials, and Consumer Staples holdings all meaningfully outperforming the Russell 2500 Value sector performance. Within Industrials, transportation-related holdings Knight-Swift and Air Transport Services Group were among the strong performers. Long-time winners Tractor Supply and William-Sonoma led Consumer Discretionary gains on the heels of strong earnings and positive guidance. JOANN, however, disappointed as sales fell short in the summer months before the resurgence of Covid cases. Other standout individual winners included ARKO, Devon Energy and Axos Financial.

Real Estate Investment Trusts and Information Technology were sector detractors for the period. Immersion declined during the quarter on soft gaming revenue as their largest customer, Sony, shipped less consoles due to supply chain issues. With nearly \$4 per share of net cash and projected earnings of \$0.89 next year, the stock appears extremely undervalued. Despite exceptional earnings reports, Haverty Furniture and Cerence saw their stocks correct from recent moves higher.

During the quarter we took advantage of strength to sell Air Transport Services Group. Our Real Estate Investment position was bolstered with a new position in Alpine Income Property Trust and additions to VICI Properties. Within Financials, we trimmed American Financial Group in favor of Argo Group International. In addition, a number of existing holdings were trimmed or added to opportunistically during the period.

Please contact us for a more detailed portfolio analysis and update.

Michelle E. Stevens, CFA
Portfolio Manager

Top 5 Small/Mid Value Portfolio Contributors			Bottom 5 Small/Mid Value Portfolio Contributors		
Security	Avg. Weight	Contribution	Security	Avg. Weight	Contribution
Devon Energy	1.39	0.33	JOANN, Inc	2.19	-0.67
Axos Financial	2.70	0.30	Immersion Corp	1.95	-0.49
Williams-Sonoma, Inc	2.54	0.28	Cerence Inc	2.04	-0.20
Knight-Swift Transportation	2.01	0.23	Ciena Corporation	1.98	-0.20
Coterra Energy	0.90	0.22	Haverty Furniture	0.82	-0.19

Top 5 Small Cap Value Portfolio Contributors			Bottom 5 Small Cap Value Portfolio Contributors		
Security	Avg. Weight	Contribution	Security	Avg. Weight	Contribution
Axos Financial	2.80	0.31	JOANN, Inc	1.89	-0.62
Knight-Swift Transportation	2.08	0.23	Immersion Corp	1.96	-0.49
Coterra Energy	0.95	0.23	Haverty Furniture	1.44	-0.34
ARKO Corp	2.29	0.22	Cerence	2.45	-0.25
First American Financial	1.17	0.22	Atlantica Sustainable Infrastructure	3.67	-0.21

	Baird Small/Mid Value Composite Performance							Baird Small Value Composite Performance						
	QTD	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception (1/1/00)	QTD	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception (3/1/05)
GROSS OF FEES	0.04	13.06	40.71	3.86	8.34	12.07	10.85	-0.95	11.98	42.83	3.87	8.13	11.29	8.67
NET OF FEES	-0.20	12.31	39.51	2.99	7.44	11.17	9.88	-1.07	11.59	42.23	3.38	7.60	10.70	7.89
INDEX*	-2.07	20.14	54.39	8.87	10.49	13.35	10.05	-2.98	22.92	63.92	8.59	11.03	13.22	7.99

* Index for the Baird Small/Mid Value Composite is the Russell 2500 Value. Index for the Baird Small Value Composite is the Russell 2000 Value.

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.

Performance for the Small & Small/Mid Value Strategies can be found on our website BairdEquityAssetManagement.com, or by clicking on the following links: [Small Cap Value Strategy](#) & [Small/Mid Cap Value Strategy](#).

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 Value Index measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2500 Index companies with lower price-to-book ratios and lower forecasted growth values. The Russell Indices are a trademark of the Frank Russell Company. The Russell 2000 Value Index measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values. The Russell Indices are a trademark of the Frank Russell Company. Indices are unmanaged and direct investment is not possible.

This commentary represents portfolio management views and portfolio holdings as of 09/30/21. 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.

Investment Professional	Years of Experience	Years with Baird	Educational Background
Michelle Stevens, CFA Senior Portfolio Manager	28	9	MBA – (University of Cincinnati) BS – Economics (Wittenberg University)
Richard Roesch, CFA Senior Research Analyst	28	9	BS – Finance (Butler University)
Jonathan DeMoss, CFA, CPA, CFP Senior Research Analyst	25	9	MBA – (Indiana University) BS – Accounting & Management (Iowa State University)
Rob Zwiebel Portfolio Specialist & Consultant Relations	30	9	BS – Finance (University of Dayton)
Jesse Parsons Trading & Operations Analyst	16	9	BBA – Finance & Marketing (University of Kentucky)