Baird Mid Cap Growth Equity

MARKET UPDATE

A strong July rally following a difficult first-half market environment provided relief to equity markets, only to see the resumption of sharply rising rates and a murkier economic outlook wipe out the gains by quarter end. In response to persistently high inflation readings, Fed tightening continued with two 75 basis point increases to the Federal Funds rate which served as a weight on valuation multiples. Reductions in forward earnings estimates, which is a function of growing recession risk, have become more frequent as well. Quarter benchmark sector returns were in a fairly tight range, apart from energy where performance tends to benefit from elevated inflation environments.

PORTFOLIO COMMENTARY

The Baird Mid Cap Growth portfolios held ground during the third quarter, advancing +0.5%, net of fees, compared to a -0.7% decline in our primary benchmark, the Russell MidCap® Growth Index. Favorable and balanced relative performance from most portfolio sectors underpinned the overall outperformance in the quarter, with energy and healthcare being the only two lagging sectors. Additional sector thoughts and comments on the portfolio changes follow.

The consumer discretionary sector led the way and held a slight relative performance edge over several other sectors. The breadth of returns generated throughout the sector was quite wide, likely owing to the uncertain economic environment. Several portfolio holdings in the retail channel stood out, notably Etsy, Floor & Décor, O'Reilly Automotive and Five Below. Chipotle also performed well. The companies generally reported solid earnings results, which allowed for some meaningful recapture of price weakness in the first half of the year. For the past several quarters, we have carried an underweight sector position in consumer discretionary, which has served us well given fundamental headwinds that have developed. With interest rates up meaningfully, the outlook remains challenged; however, we also believe we are seeing opportunities where the risk/return equation is in our favor. This assessment led us to add to a few lower weight positions, D.R. Horton, Five Below, O'Reilly Automotive, and Williams-Sonoma. We know from prior cycles that consumer discretionary stocks, and particularly retail, tend to lead on the way out of economic weakness. We continue to be underweight the sector but will look to selectively close that gap over time.

The technology sector was again a positive contributor as solid returns in the software industry group, the portfolio's largest industry exposure, outweighed underperformance from our semiconductor holdings and poor performance from NCR and Match Group. Within software, Cadence Design Systems, Tyler Technologies and PayCom performed well and, while the economy may affect the trajectory of their growth, we believe the businesses remain well-positioned to take market share and deliver strong returns over time. EPAM continued to recover from the early year sell-off related to the Ukraine invasion, which adversely impacted a portion of their employee base, as reported quarterly earnings demonstrated business resiliency and growth. Globant also performed well, likely in sympathy with EPAM. The two stocks remain vulnerable to news flow regarding the war, but we see attractive long-term fundamentals. We made a few changes during the quarter, selling VeriSign and Match Group, and trimming PayCom, while adding back a portion of the capital to Globant. VeriSign looks like it will grow at a slower rate than we expected, and the thesis on Match, of brand monetization and a post-Covid dating recovery, did not play out as expected. NCR's price weakness followed the completion of a strategic review and subsequent announcement that it plans to separate into two publicly listed companies, versus expectations for a sale to an interested buyer. To date, it has been a disappointing investment.

Despite building worries over the path of the economy, the portfolio's industrial stocks posted a collective positive return and were a help to overall relative performance. Advanced Drainage Systems, HEICO Corporation, IDEX, and Keysight Technologies led the way as good execution and secular growth trends in their respective end markets is driving favorable fundamental trends. Their strength more than offset tough quarters from Euronet, Generac, Transunion and Trex, which are experiencing near-term disruptions in demand. Amid the volatility we saw an opportunity to return to our prior long-time holding, Watsco, a leading HVAC distributor. The business has demonstrated strong pricing power historically, which we find valuable in today's higher-inflation environment.

Returns in the healthcare sector have been challenged all year and led the benchmark to the downside in the quarter. Portfolio holdings fared a bit worse, which is disappointing given our overweight position and expectation for some stability in a choppy market environment. A few company-specific issues drove most of the underperformance. Catalent was the biggest detractor as it struggled after reporting earnings and conveying a softer outlook. The stock weakened further on news of a manufacturing disruption which, though temporary, compressed valuation. We believe manufacturing challenges will be resolved in a timely manner and accounting for the normalization of Covid-related revenues still leaves an attractive long-term growth company. Steris, a relatively recent addition to the portfolio, also struggled and we decided to exit our position following a worse than expected legal outcome for its competitor, Sotera Health, in the first of several upcoming sterilization emissions trials. While Steris is not implicated in any lawsuits today, we believe uncertainty has compromised our risk/reward opportunity. We moved some of this capital back into IDEXX given the pullback in price. The healthcare sector has historically provided us with ample opportunities to invest in companies with attractive secular growth. While multiple compression and some company specific challenges have weighed on relative performance this year, we continue to like our mix of companies and anticipate we will find other good long-term opportunities in this sector.

The portfolio's financial services holdings outpaced sector returns. On top of solid performance from Broadridge and MSCI, Pinnacle Financial Partners performed well as an outlook for solid loan growth and a rising margin allowed the company's earnings outlook to lift nicely. Regarding changes, we purchased Kinsale, a growing property and casualty insurance business. The company is founder-led, and we expect continued market share gains and a favorable pricing environment to produce outsized sales and earnings growth for several years. Capital for the Kinsale purchase came from the sale of Western Alliance, which reduced our bank exposure as well as exposure to a potentially weaker economic backdrop.

Of the smaller weighted sectors, we would highlight consumer staples, real estate, and telecommunications as solid contributors to relative performance. Lamb Weston, within consumer staples, delivered strong absolute performance as the stock responded well to a solid quarterly earnings report. Within real estate, the sector benefitted from strength in CoStar on positive fundamental trends, and weakness in REITs which likely underperformed due to sharply rising interest rates. Arista Networks, our single telecom holding, was one of the portfolio's top absolute return stocks in the quarter as spending into the company's product set remains robust.

The energy sector delivered the largest hit to relative performance, which is the result of an underweight to the strong sector performance and a decline in SolarEdge, a newer holding. As noted last quarter, we adjusted our positioning mid-year by adding Diamondback Energy and SolarEdge to address the increased sector weight post benchmark rebalance. Diamondback, a prior holding, should benefit from elevated oil prices and its history of disciplined capital management. SolarEdge pulled back following quarterly earnings which highlighted margin pressure and supply constraints. We continue to believe solar power generation will grow significantly over time, and issues within the quarter will be resolved.

OUTLOOK

Very few quarters have included two 75 basis point rate increases by the Federal Reserve and, with the prospect for a repeat performance in the fourth quarter, the investment environment is likely to remain challenging. We would note that various sentiment measures suggest the near-term market view is quite negative, which is not overly surprising given elevated geopolitical risk, persistent inflation, the substantial drawdown in equity prices year to date, and the uncertainty that accompanies election season. Whether or not we get a full-fledged bounce in equity prices, we know that valuations have contracted meaningfully in response to higher inflation and interest rates. We believe our long-standing, high-quality growth investment philosophy can serve investors well and we will be looking to use volatility to our advantage to find new ideas or invest more heavily in our portfolio companies.

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

Baird Mid Cap Growth Equity (Q3 2022)

PERFORMANCE

Periods Ending September 30, 2022* (%)	Total Return (%)		Average Annual Total Returns (%)				
	QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception (06/30/1993)
Baird Mid Cap Growth Composite (Gross)	0.67	-30.00	-24.72	7.61	11.12	11.66	11.82
Baird Mid Cap Growth Composite (Net)	0.53	-30.36	-25.21	6.87	10.35	10.87	11.19
Russell MidCap Growth Index	-0.65	-31.45	-29.50	4.26	7.62	10.85	9.43

*Returns over one year are annualized unless otherwise specified. Performance data represents past performance and does not guarantee future results. Current performance data may be lower or higher than the data quoted. For performance data to the most recent month end, contact Baird Equity Asset Management directly at 800-792-4011.

TOP & BOTTOM CONTRIBUTORS

Top 5 Portfolio Contributors	Avg. Weight	Contribution
Advanced Drainage Systems (WMS)	2.08	0.50
EPAM Systems (EPAM)	2.32	0.31
Paycom Software (PAYC)	1.90	0.31
Arista Networks (ANET)	1.89	0.29
Keysight Technologies (KEYS)	2.61	0.28

Bottom 5 Portfolio Contributors	Avg. Weight	Contribution
Euronet Worldwide (EEFT)	1.27	-0.32
ICON Plc (ICLR)	2.27	-0.32
TransUnion (TRU)	1.60	-0.39
NCR Corporation (NCR)	1.20	-0.46
Catalent (CTLT)	1.80	-0.60

BAIRD MID CAP GROWTH INVESTMENT TEAM

Investment Professional	Years of Experience	Years with Baird	Coverage Responsibility	Educational Background
Chuck Severson, CFA Senior Portfolio Manager	35	35	Generalist	MS – Finance, The Applied Security Analysis Program BBA – Accounting and Finance (UW-Madison)
Ken Hemauer, CFA Co-Portfolio Manager	28	28	Financials	MS – Finance, The Applied Security Analysis Program BBA – Finance (UW-Madison)
Jonathan Good Senior Research Analyst	23	16	Healthcare	MBA – (Northwestern University-Kellogg) BS – Applied and Biomedical Sciences (Pennsylvania)
Corbin Weyer, CFA, CPA Director of Research & Senior Research Analyst	12	12	Consumer Discretionary & Staples	BSBA – Finance and Accounting (Marquette University)
Doug Guffy Senior Research Analyst	39	18	Energy, Industrials & Materials	MBA – Finance (Ball State University) BA – Economics & Government (Anderson University)
Karan Saberwal Senior Research Analyst	6	3	Information Technology	MBA – (Northwestern University-Kellogg) BE – Bachelor of Engineering (Army Institute of Technology, University of Pune)
Josh Heinen Research Analyst	1	1	Healthcare & Financials Focus	MS – Finance, The Applied Security Analysis Program BBA – Accounting and Finance (UW-Madison)
Margaret Guanci Research Analyst	<1	<1	Technology Focus	BBA – Finance (UW-Madison)

This commentary represents portfolio management views and portfolio holdings as of 09/30/22. 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.

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.

Composite's 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.

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