

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 mixed, with positive returns in energy, healthcare and telecommunications, offset by declines in consumer staples, technology, and basic materials.

PORTFOLIO COMMENTARY

The Baird Small/Mid Cap Growth strategy declined -0.6% in the third quarter, net of fees, compared to the -0.1% drop in our primary benchmark, the Russell 2500 Growth Index. Our slight underperformance for the quarter was mostly due to our style positioning versus the benchmark on factors such as valuation and profitability. Unprofitable stocks did better than profitable, and lower returns (based on ROIC and ROA) did better than higher returning businesses. Recall our portfolios typically have much higher profitability and return characteristics relative to the R2500G benchmark.

Industrials generated the best relative return in the third quarter. We view the Russell “industrials” description to be overly broad, as this industry grouping contains several companies we would classify as technology, financials, and business services. We remain quite diversified within this sector and have exposure to both secular and cyclical businesses, which we believe gives the portfolio both offensive and defensive exposure depending on whether the market is increasing or decreasing over a specific period. Two of the best performing stocks in the quarter were WillScot Mobile Mini and Advanced Drainage Systems. In addition to reporting strong quarterly earnings, both companies should benefit from the recently passed Inflation Reduction Act legislation that provides added stimulus. Paylocity was the best performing stock in the sector, which we believe was due to the company’s announcement of future financial guidance that was well above expectations given worries over payroll growth in a slowing economy. Finally, payment processor Shift4 Payments also contributed positively to relative performance as the company continues to benefit from an increase in travel, hospitality, dining, and in-person stadium events where the company’s technology has strong market share. Offsetting those positive developments were lagging holdings such as Oshkosh, Mastec, and Littlefuse. All three of those holdings reported earnings results that were below investor expectations.

The consumer discretionary sector generated positive absolute and relative outperformance in the third quarter. The breadth of returns generated throughout the sector was quite wide likely due to the uncertain economic environment. Several portfolio holdings in the retail channel stood out, notably Deckers Outdoor, Floor & Décor, Five Below, and Williams-Sonoma. 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, which has served us well given fundamental headwinds that have developed. Our consumer holdings that underperformed in the quarter have exposure to housing/interest rates - Leslie’s, SiteOne, and Pool Corp. We sold our position in Leslie’s as we no longer have conviction in the growth thesis in this environment. 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. 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 worst performing sector in the quarter was healthcare, where portfolio returns were negative and benchmark returns were positive. Healthcare was the strongest relative performing sector in our strategy through the first half of the year, but many holdings declined along with the market in the third quarter, particularly in September. 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. Icon, a long-term holding, was also a detractor in the quarter as a competitor in September noted

Baird Small/Mid Cap Growth Equity (Q3 2022)

slowing R&D spending from certain biotech customers. This has been a worry among investors this year given slower capital markets funding activity in 2022. Finally, Jazz Pharmaceuticals sold-off in September on worries of slowing sales for a recently acquired drug. Several other holdings declined double digits in the quarter, again, mostly in September as the market was under pressure. There were a few positive standouts in the quarter as well, including Shockwave Medical, which continues to exceed analyst revenue growth expectations. Repligen also reported strong quarterly results despite worries from the market that revenues would be affected by slowing Covid cases and vaccine production. In total, we made a few trades in the quarter, buying Revance Therapeutics (received FDA approval for its long-acting botox-like product) and IRhythm Technologies (a high growth cardiac monitoring company with improving profitability). We sold our position in Cooper, as the company faces difficult foreign currency comparisons which will slow earnings growth.

The technology sector was a slight relative underperformer in the quarter. Similar to Paylocity, smaller cap payroll software vendor Paycor also reported strong growth in the face of worries over slowing employment trends. The portfolio also benefited from profitable holdings such as semiconductor manufacturer Monolithic Power, IT-services company Globant, and transportation software vendor Descartes Systems group. Two companies of note reported disappointing developments in the third quarter. NCR Corp announced a decision to split into two public companies, and we sold the stock as we had anticipated the company would be sold to a private equity sponsor. Sitime, a newer smaller cap semiconductor holding, noted a surprise slowdown in their consumer segment near the end of the second quarter and expect slower growth for the remainder of the year.

The remaining sectors, such as basic materials, energy, financials, telecommunications, real estate, and consumer staples are each less than 6% of the benchmark. Often, we may have only one (or zero) holding in each of these sectors. The collective performance impact of the sectors can be meaningful depending on the performance of the individual stocks in each group. For the quarter, the net effect was essentially flat. Lamb Weston, within consumer staples, delivered positive returns and RBC Bearings drove basic materials' relative outperformance, as the stock responded well to a solid quarterly earnings report. Energy holdings were a detractor, mostly due to SolarEdge, which 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 Small /Mid Cap Growth Strategy.

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PERFORMANCE

Periods Ending September 30, 2022* (%)	Total Return (%)		Average Annual Total Returns (%)			
	QTR	YTD	1 Year	3 Year	5 Year	Since Inception (09/30/2015)
Baird Small/Mid Cap Growth Composite (Gross)	-0.34	-28.44	-24.69	10.62	12.94	13.92
Baird Small/Mid Cap Growth Composite (Net)	-0.56	-28.89	-25.32	9.70	12.00	12.98
Russell 2500 Growth Index	-0.12	-29.54	-29.40	4.76	6.30	8.84

*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
Shockwave Medical (SWAV)	3.18	0.90
Advanced Drainage Systems (WMS)	2.09	0.50
WillScot Mobile (WSC)	2.62	0.46
Deckers Outdoor Corporation (DECK)	1.99	0.32
Paylocity (PCTY)	1.22	0.31

Bottom 5 Portfolio Contributors	Avg. Weight	Contribution
National Storage Affiliates (NSA)	1.98	-0.29
ICON Plc (ICLR)	2.21	-0.31
Bio-Techne (TECH)	2.03	-0.31
Littelfuse, Inc. (LFUS)	1.77	-0.36
Catalent Inc (CTLT)	2.00	-0.66

BAIRD SMALL/MID CAP GROWTH INVESTMENT TEAM

Investment Professional	Years of Experience	Years with Baird	Coverage Responsibility	Educational Background
Jonathan Good Portfolio Manager	23	16	Healthcare	MBA – (Northwestern University-Kellogg) BS – Applied and Biomedical Sciences (Pennsylvania)
Ken Hemauer, CFA Senior Research Analyst	28	28	Financials	MS – Finance, The Applied Security Analysis Program BBA – Finance (UW-Madison)
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)
Chuck Severson, CFA Mid Cap Growth PM	35	35	Generalist	MS – Finance, The Applied Security Analysis Program BBA – Accounting and 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 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.

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