

Baird Small/Mid Cap Growth Equity

MARKET UPDATE

The CPI data released early in the quarter fell squarely on the side of milder inflation, and the equity market quickly began discounting the likelihood of the Federal Reserve accelerating the start of an easing cycle. The Fed obliged with a larger than expected 50 basis point interest rate cut at its September meeting following a weak employment report early in the month, which propelled stocks higher into quarter end on the prospects of an economic soft landing. Equity market strength belied the escalating risk from conflict in the Middle East and the general heightened level of geopolitical tension.

PORTFOLIO COMMENTARY

The Baird Small/Mid Cap Growth portfolio increased +6.9% in the third quarter, net of fees, compared to the +7.0% increase in our primary benchmark, the Russell 2500 Growth Index. In our opinion, the quarter was quite volatile, as the market rallied nearly 8% early in July, followed by sharp selloffs at the beginning of both August and September. In our view, factors were not a major headwind or tailwind in the quarter, and we were encouraged to return to a more “normal” performance profile, keeping pace with a solid benchmark return in the quarter.

On a relative basis, technology was the best performing sector in the third quarter, as we saw several holdings outperform in a variety of subsectors including software, semiconductors, and IT-services. Favorable stock price reactions to strong quarterly earnings results benefited several holdings, including SiTime, CACI International, Tyler Technologies, Manhattan Associates, and Monday.com. The main positions that lagged on a relative basis in the quarter were Procore Technologies, Axcelis Technologies, AppFolio, and Onto Innovation. We made several changes in the sector throughout the quarter, initiating three new positions (Astera Labs, CyberArk Software, and Axcelis Technologies), and exiting four (Bentley Systems, Lattice Semiconductor, Procore Technologies, and Tyler Technologies). Astera is a fast-growing and profitable developer of semiconductor products known as retimers that are a key enabler of AI workloads that help prevent GPU bottlenecks. We believe this business adds further profitable AI-exposure to the portfolio. CyberArk has the leading market position in cybersecurity software known as “Privileged Access Management” which we believe should deliver solid revenue growth along with profit margin expansion. Axcelis is a manufacturer of components used in semiconductor manufacturing, and we feel the company can expand gross margins as some of their end markets recover. We sold Bentley Systems due to concerns over the company’s ability to accelerate growth, and Lattice Semiconductor on a surprise CEO departure combined with weaker relative fundamentals. We also exited our position in Procore Technologies after the company made major organizational changes to alter its go-to-market strategy during a period of macro weakness. Finally, to remain “true SMID” and ensure consistency in our investment philosophy, we exited Tyler Technologies as the company surpassed our \$25 billion market cap maximum. Tyler has been in the portfolio since inception and was a fantastic investment over the past nine years.

Financials also drove relative outperformance in a strong sector. Although it is only three positions and roughly 6% of the portfolio, all holdings benefited from continued strong execution and business momentum, including Clearwater Analytics (back-office software), Kinsale Capital (insurance), and FactSet Data Systems (financial data provider).

Quarterly performance in the industrials sector was mixed, although strong capital allocation led to slight outperformance in the quarter. Given the diverse nature of the sector and our individual portfolio holdings, there was no single consistent theme driving positive results. Strong contributors in the quarter included: AAO (data center exposure); Shift4 Payments (improving consumer/travel activity); Kadant (strong quarterly results); BWX Technologies (favorable nuclear industry trends); and EXL Service (waning fears of AI impacting the core business). Offsetting those gains were modest setbacks, in our opinion, across four holdings: Trex (inventory de-stocking leading to guidance cut); UL Solutions (secondary offering); WillScot (weak construction trends); and IDEX (continued life sciences weakness). During the quarter, we initiated two new positions and exited two as well. We purchased UL Solutions, which is the leading testing, inspection, and certification (TIC) company, with only 7% market share. We believe the company’s recurring revenue business model could prove resilient regardless of the macroeconomic environment, as the company’s mid-single digit revenue growth should compound returns for many years.

Baird Small/Mid Cap Growth Equity (Q3 2024)

We also purchased Badger Meter, which provides a comprehensive suite of digital water offerings that allows their customers to improve operating efficiency, resiliency, and sustainability. This small cap company has a track record of consistent, secular revenue growth and margin expansion, which we believe should continue. Littlefuse and Jack Henry were sold as we lost conviction in the longer-term growth story and were frustrated with the sideways movement in stock price over the last few years.

Consumer discretionary's relative performance was mostly flat, with a handful of both winning and losing positions throughout the quarter. Given the reduction in the federal funds rate announced in September, stocks with housing exposure rallied, including LGI Homes, Pool Corp, and Floor and Décor. However, the strongest contributor in the quarter was Boot Barn, which continues to improve its comparable store sales growth after outsized growth throughout Covid. Offsetting those gains, Dutch Bros weighed on performance as new unit and sales growth outlooks fell short of market expectations in their earnings release. We recognize younger restaurant concepts can have fits and starts as they calibrate good operational execution against a large growth opportunity. We also saw disappointing results from Five Below, which was a surprise as exposure to value retail in the past performed much better amid a slowing economy. Given the poor results, as well as a change in CEO, we decided to move on due to concerns that competitive challenges and execution issues would persist. Burlington Stores, a former holding, was our one new purchase in the quarter. We envision steady performance (high single digit sales growth and improving profit margins) from a low-priced retailer in a challenging macro environment that is affecting consumer spending.

Healthcare performance was also mixed in the quarter, netting out negative on a relative basis. Several holdings were positive contributors, such as Inspire Medical (improving growth and profitability), Procept Biorobotics (a new product announced), Tarsus Pharmaceuticals (encouraging new drug launch trajectory), and Insulet (new indication approved earlier than expected). Unfortunately, those positive developments were offset by setbacks from Neurocrine Biosciences (clinical trial results), RxSight (worries over capital equipment demand), MedPace Holdings (elevated cancellations from biotech customers), and iRhythm Technologies (continued FDA challenges). We sold our position in iRhythm due to ongoing challenges with the FDA around device filing as well as manufacturing quality controls.

Underperformance in consumer staples was primarily due to Lamb Weston, which sold off materially on quarterly earnings that highlighted a weakening end-market, weighing on industry capacity utilization and earnings power. In this case, we are sticking with the company as we feel that management initiatives will lead to a recovery in fundamentals and the stock price in coming quarters. We initiated a new position in Casey's, which is a dominant, Midwest-concentrated convenience store operator. The business's competitive positioning has strengthened due to multiple years of high inflation pressuring inferior peers. Additionally, we believe newer management can further improve store operations and better execute acquisitions and organic unit growth. Lastly, we exited our position in Simply Good Foods. Although Quest brand sales remained quite strong, they continued to be offset by slowing Adkins brand sales.

Finally, Energy was a negative contributor in the quarter given the interest rate/inflation changes and its impact on oil prices. We anticipate macro events will continue to result in volatility in the sector, which is nothing new. During the quarter, we initiated a position in Viper Energy. Viper is a mineral rights company majority owned by Diamondback Resources. We are fond of Viper for its fantastic business model, which offers a growing royalty on Permian production without the capital intensity of E&Ps, reasonable valuation, and potential to be misunderstood as a former MLP.

OUTLOOK

After the most difficult eight-month period in the history of our strategy, we are encouraged with the improvement in relative performance in the third quarter.

That said, year-to-date, a combination of market characteristics and stock picking challenges have tested the portfolio. While the timing of a more favorable backdrop for our investment style is uncertain, what is certain is the dedication to our long-standing investment process and philosophy. Remaining steadfast to our philosophy has served as the foundation of building a strong investment record over our nine-year history. We remain confident in our team, we value the stability that Baird provides, and we appreciate the patience and trust of our investors.

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

Baird Small/Mid Cap Growth Equity (Q3 2024)

PERFORMANCE

Periods Ending September 30, 2024* (%)	Total Return (%)		Average Annual Total Returns (%)			
	QTD	YTD	1 Year	3 Year	5 Year	Since Inception 09/30/2015
Baird Small/Mid Cap Growth Composite (Gross)	7.03	3.28	11.52	-3.73	9.91	12.77
Baird Small/Mid Cap Growth Composite (Net)	6.86	2.74	10.74	-4.49	9.02	11.85
Russell 2500 Growth Index	6.99	11.20	25.20	-0.75	9.75	10.74

*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.

BAIRD SMALL/MID CAP GROWTH INVESTMENT TEAM

Investment Professional	Years of Experience	Years with Baird	Coverage Responsibility	Educational Background
Jonathan Good Senior Portfolio Manager	24	18	Healthcare	MBA – (Northwestern University-Kellogg) BS – Applied and Biomedical Sciences (Pennsylvania)
Ken Hemauer, CFA Senior Research Analyst	30	30	Financials	MS – Finance, The Applied Security Analysis Program BBA – Finance (UW-Madison)
Corbin Weyer, CFA, CPA Director of Research & Senior Research Analyst	14	14	Consumer Discretionary & Staples	BSBA – Finance and Accounting (Marquette University)
Karan Saberwal Senior Research Analyst	8	6	Information Technology	MBA – (Northwestern University-Kellogg) BE – Bachelor of Engineering (Army Institute of Technology, University of Pune)
Christopher Brennan Senior Research Analyst	5	1	Energy, Industrials & Materials	MBA – Finance (The Wharton School of Pennsylvania) BA – Economics and Mandarin Chinese (Washington University in St. Louis)
Josh Heinen, CFA Research Analyst	3	3	Generalist	MS – Finance, The Applied Security Analysis Program BBA – Accounting and Finance (UW-Madison)
Margaret Guanci Research Analyst	2	2	Generalist	BBA – Finance (UW-Madison)
Chuck Severson, CFA Mid Cap Growth PM	37	37	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 09/30/2024. 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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First use: 10/2024