

Baird Small/Mid Cap Growth Equity

Q4 2021 COMMENTARY

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Baird Equity
Asset Management

MARKET UPDATE

Fourth quarter returns for the Russell 2500 Growth benchmark were essentially flat, as returns from smaller cap growth stocks lagged the returns of mid and large cap growth stocks. In contrast to the S&P 500 Index returns of greater than 10% in the quarter, the Russell 2500 Growth Index returned only 0.2%. Continuing a trend seen throughout most of 2021, benchmark returns were volatile intra-quarter, peaking at up almost 10% in early November before declining to -5% through mid-December.

The flow through effects of significant pandemic related monetary and fiscal support have helped push unemployment lower, wages meaningfully higher and set in place a significant increase in demand for products and services across the economic spectrum. While long-term effects of the stimulative policies are yet to be determined, the near-term corporate earnings recovery from the pandemic's severe impact has been impressive. Rising inflation expectations and the emergence of a new and highly contagious Covid-19 strain became an increasing concern for growth stock investors. Whether bolstered by prospects of quickly reaching herd immunity, or the surprising decline in interest rates – our target index regained its footing late in the quarter to finish roughly flat. Notably, performance characteristics underneath the broader market strength shifted during the second half of the year, a development we'll discuss further below.

PORTFOLIO COMMENTARY

The Baird Small/Mid Cap growth fund returned 5.2%, gross of fees, in the fourth quarter of 2021, generating roughly 500 basis points of outperformance versus the Russell 2500 Growth benchmark return of 0.2%. Similar to last quarter, the magnitude of quarterly outperformance was one of the strongest since strategy inception. 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. Trading activity was a bit higher than normal as we adjusted the portfolio for a variety of reasons discussed below.

Performance in the fourth quarter was broad-based, as nearly all sectors were positive relative contributors. The four strongest sector contributors (also the largest by weight) were healthcare, consumer discretionary, industrials, and technology. While benchmark returns in healthcare were down almost 9% and by far the worst performing sector in the quarter, our relative performance was slightly positive due to minimal exposure to biotech. Our positive relative outperformance was driven by Icon, Avid Bioservices, Bio-Techne, and Conmed. Icon, our largest holding in the sector, delivered a good quarter as the management team has executed well within a growing end market for contract research among biopharmaceutical companies. The company continues to serve the role of a trusted teammate – not flashy, but fundamentally sound and consistent. We did make a few portfolio adjustments during the quarter. We trimmed and took profits in both Repligen and Insulet and added to our positions in Conmed and Masimo. We sold our position in LHC Group, as we believe worsening Covid trends continue to pressure the business, as well as increasing wage pressure and hiring challenges that we believe will persist for the foreseeable future. We are also exited Revance after documents from the FDA were published regarding negative deficiencies found at the company's manufacturing facilities. Shortly after this news, the company received a Complete Response Letter (negative decision) from the FDA delaying approval of Revance's key franchise product.

The second strongest relative performing sector in the fourth quarter was consumer discretionary. Benchmark returns were roughly flat, but our holdings returned almost 10%, led by long term holdings Pool Corp and SiteOne Landscape supply. We made a variety of portfolio adjustments throughout the quarter. We took profits and trimmed positions in SiteOne and Five Below, and we added to Leslie's, as we believe positive trends around swimming pool construction and spending will continue well beyond the pandemic. Similar to our sale of LHC Group, we exited Terminix given worries over wages and labor in 2022. Finally, we made two

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: 20 years

trades intra-quarter in Crox. We trimmed the stock early in the quarter to take profits given the significant appreciation in the stock price since the March 2020 market bottom. We ultimately sold the rest of our position after the company announced an acquisition at the very end of December as we did not think the deal was a good use of capital and the original thesis would need to change.

Portfolio attribution was positive in the broad-based industrials sector led by strong returns from Trex, Willscot Mobile Mini, and Advanced Drainage Systems. Trex stock rose after positive quarterly earnings, highlighting strong product demand that we anticipate will continue into 2022. Littlefuse, Knight-Swift Transportation, Oskosh, and Kadant were also standouts, as economic strength reached across industry groups. We remain overweight the sector based on the belief that economic momentum will continue to lift earnings, although we are increasingly mindful of a Federal Reserve dealing with inflation pressures. It wasn't all smooth sailing as Euronet declined on the prolonged travel headwinds which are hurting international consumer activity in their target markets. We trimmed our position in front of the Euronet earnings report and decided to exit completely later in the quarter given the emergence of the Omicron variant. Those same worries caused us to exit our position in ShiftFour, as well as the broader weakness across the entire payments industry. We added to our position in Oshkosh and purchased IDEX, a stock we've owned previously and continue to view as a high-quality industrial business.

Technology sector returns on a relative basis were slightly positive. Strong quarterly results from several holdings such as Endava, Tyler, Lattice Semiconductor, and Globant benefited the portfolio. This was balanced out by weakness mostly in our higher growth, higher multiple software holdings such as Paycor, Five9, Qualtrics, and Avalara. Despite solid fundamental performance from those holdings, we believe the worry over rising interest rates drove a sell-off in stocks with high valuations. During the quarter, we added to both Five9 and Qualtrics. We also initiated a new position in Digital Ocean, a high growth company that provides small and medium sized businesses with cloud-based software solutions and infrastructure.

Finally, performance was mostly positive in the smaller weighted sectors, which in many cases represent only a single stock. Positive contributors included Lamb Weston (consumer staples), Vocera (telecommunications), and National Storage Affiliates (real estate). Energy performance was flat, with gains from larger cap solar company Enphase offset by declines with smaller cap oilfield technology company ChampionX. During the quarter we added to our Enphase position, as the company suggested that supply chain headwinds were improving heading into 2022. Lastly, financials performance was slightly negative in the quarter, with positive contributions from Focus, offset by declines from both Kinsale and Western Alliance. We added to our Focus position and decided to sell our long-time holding Kinsale. Kinsale was a significant positive performer in the portfolio for several years, and we decided to exit should their business slow and the multiple contract.

OUTLOOK

The U.S. equity market delivered the best of both worlds in 2021 - strong returns accompanied by limited volatility. The underpinnings of significant fiscal and monetary stimulus supported asset prices and spurred demand across the economic spectrum and investors benefitted. Historically, a year with such a strong market advance and few bumps is followed by a year with more volatility and muted returns. That outcome would not be too surprising following three years of positive returns for the benchmark and a Federal Reserve now wrestling for the first time in decades with meaningfully higher than expected inflation.

Time will tell whether quality characteristics will continue to drive equity returns going forward as they did in the second half of 2021. Past data tells us that the best set up for stock performance is low and stable inflation and solid corporate earnings growth. Economic fundamentals suggest a good backdrop for continued earnings growth, but correctly calling the market's short-term direction amid a significant shift in Fed policy, not to mention the uncertain path of Covid-19, is difficult. Our focus is best kept on identifying well-managed, profitable, and growing businesses that we believe can generate attractive returns over time.

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	22	15	Healthcare	MBA – (Northwestern University – Kellogg) BS – Applied and Biomedical Sciences (Pennsylvania)
Ken Hemauer, CFA Senior Research Analyst	28	28	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	12	12	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	35	35	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
Pool Corporation (POOL)	3.14	0.77	Revance Therapeutics (RVNC)	0.10	-0.25
Trex Company (TREX)	2.39	0.58	Five9 (FIVN)	1.73	-0.28
Endava Plc (DAVA)	2.16	0.48	Shift4 Payments (FOUR)	0.38	-0.30
SiteOne Landscape Supply (SITE)	1.88	0.47	Paylocity Holding (PCTY)	2.31	-0.35
WillScot Mobile Mini Holdings (WSC)	1.94	0.47	Avalara (AVLR)	1.66	-0.46

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

	QTD ¹	1 Year	3 Years	5 Years	Since Inception (9/30/15)
Composite – Gross	5.23	19.42	34.00	25.81	22.07
Composite – Net	5.02	18.45	32.88	24.78	21.07
Russell 2500 Growth Index	0.20	5.04	25.09	17.65	16.28

*12/31/2021 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 12/31/21. 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.