2022 Commentary and Market Outlook

Baird Equity Opportunity Fund

Baird Equity Asset Management

PORTFOLIO COMMENTARY

Equities sank in 2022 as persistent inflation forced interest rates higher and valuations lower. The Russell 2000 Index declined -20.4%, the largest annual retrenchment in over a decade. The Institutional Class shares of the Baird Equity Opportunity Fund fell -11.6% on a net basis, a solid result that outperformed the Index by 880 basis points for the year*.

Market action in 2022 was dominated by the reversal of the Federal Reserve's long-held commitment to ultra-loose monetary policy in an effort to quell the highest inflation in four decades. The Fed aggressively hiked interest rates and accelerated monthly reductions in the size of its balance sheet (so-called quantitative tightening (QT), tightening financial conditions and setting off various knock-on effects that negatively impacted markets. Valuations retrenched, particularly among the fastest growing and least profitable companies. It is perhaps little surprise that the technology sector declined most during the year, and growth stocks underperformed value stocks by a wide margin. Selling was at times indiscriminate, with declines in small and large issues, growth stocks and value, and across all sectors other than energy which, ironically, was the sole "green" sector.

The Fund's performance was buffeted by our detailed, flexible, and opportunistic investment process, which intensely focuses on stocks we think feature highly favorable risk-reward profiles. Perhaps more importantly, our team's discipline and experience paid off handsomely. Having collectively managed through similarly exuberant times during our careers, we generally avoided large mistakes such as investing in "growth at any price" and "FOMO" (fear of missing out) situations, as we have personally witnessed how badly these episodes typically end.

A prominent example of how our disciplined focus on risk-reward delivered outperformance lies in the Fund's investments in software, a sector that experienced notable weakness in 2022 with the average stock falling roughly 40% for the year. The Fund owned two prominent software positions, Blackbaud (BLKB) and Dropbox (DBX), both more-established, slower-growing, highly-profitable and, we believe, reasonably-valued names – the kind of companies that most tech investors eschewed in favor of faster- growing (and unprofitable) companies that led the significant sector declines. While Blackbaud and Dropbox were not unscathed – Blackbaud declined roughly 25% and Dropbox pulled back less than 10% – the more modest losses relative to the broader software sector helped sustain the Fund's relative outperformance.

We often describe our Fund holdings as "idiosyncratic", which the dictionary defines as "peculiar or individual." Our definition centers on whether the Fund holding "has a company-specific thesis" or "beats to its own drum." Either way, to the extent it smacks of marketing-speak, it's notable that the Fund had several positions that were up considerably during the year, unusual in an equity market down over 20%. Clearly, these names were in fact peculiar and did beat to their own drum. Card processor EVO Payments (EVOP), irrigation equipment manufacturer Valmont Industries (VMI), mobile video-game maker Zynga (ZNGA) and energy services provider Oceaneering (OII) all delivered gains during 2022.

***Performance data represents past performance and does not guarantee future results. The investment return and principal value of the investment will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Current performance data may be lower or higher than the data quoted. For performance data as of the most recent month-end, please visit bairdfunds.com**

BLKB had an average weight of 4.77%, DBX 4.21%, EVOP 4.69%, VMI 4.62%, ZNGA 2.52%, and OII had a 0.72% average weighting in the Equity Opportunity Fund as of 12/31/2022.

EVO Payments rose significantly on news of Global Payments' announced acquisition over the summer. While many "fintech" investors ignored the steady, high-quality nature of the company in favor of flavor-of-the-day businesses such as crypto exchanges and money-losing "buy now, pay later" names, in the end, EVOP's value was proven and recognized by the market. We are grateful that the EVO management team and Board of Directors negotiated a favorable cash deal for shareholders, and we exited the Fund's position before year end. Valmont delivered consistently strong results, supported by momentum in its irrigation equipment segment, which in turn was driven by rising crop prices globally. Zynga was acquired early in the year by Take-Two Interactive (TTWO), though the effective premium turned out to be a relatively modest one as TTWO's stock price declined after the announcement.

Our biggest detractors for the year were Clarus Corp. (CLAR), Vista Outdoor (VSTO), and Infinera (INFN). After years of strong stock price performance, Clarus declined significantly in 2022. Fundamentals were only partly to blame, as Clarus saw growth stall in the back half of the year as several of its larger retail customers sought to right-size existing inventory, impacting new order growth and product replenishment. To add insult to injury, a top holder of the stock was forced to liquidate its portfolio, placing a several million-share position for sale, negatively impacting the stock price from sheer supply increase while also inviting a spike in short-seller interest, which had an additional negative impact on the stock. We increased the Fund's position on weakness, as we believe fundamentals will recover, technical impacts should soon abate, and the valuation is compelling.

Similarly, Infinera fell for both fundamental and technical reasons. While results were solid during the year, supply chain headwinds continued to restrain revenue and profit growth during the company's all-important new optical product cycle. An ill-timed convertible bond offering delivered a body blow late in the year, as hedging transactions by the note buyers negatively impacted the equity price. We continue to believe in our Infinera investment thesis, and while a weakening economy could replace supply chain issues as a headwind, we still anticipate fundamentals to improve over the intermediate term.

Since the onset of COVID in 2020, there has been a considerable increase in investor attention toward the macroenvironment; it is easy to understand why. That year, the floodgates opened, with double-barreled monetary and fiscal stimulus. Interest rates plunged, central bank balance sheets exploded higher, and trillions of dollars were sent to American families. As a result, most companies and consumers benefited, broadly boosting corporate fundamentals over the past few years. But in 2022, the main aftereffect of COVID and this policy response began to reveal itself, rampant inflation. This spurred a reversal of the 2020 policies – interest rates rose, central bank balance sheets began to shrink, and fiscal stimulus abated. The resultant wide-ranging effects on sectors, styles, and valuations caused countless equity market participants to hang on every macro headline.

We are bottom-up fundamental investors that operate in an increasingly macro-driven environment. While we will always naturally ascribe more weight to company analysis and leveraging our domain expertise, we also appreciate the opportunity to assemble puzzle pieces in search of a macro mosaic – after all, even bottom-up investors like us must consider the bigger picture to help inform various inputs into our individual investment theses. As such, we think it is reasonable to share some top-down views of our own, especially as it pertains to the hotly-debated topics of monetary policy and the likelihood and timing of a potential recession.

While perhaps now consensus, we tend to take Fed Chairman Powell's words at face value and assume there are several more interest rate hikes ahead, accompanied by further balance sheet shrinkage. However, because we believe inflation is likely to be stickier above the Fed's low single-digit target, we would take the "over", relative to consensus, on how long it takes the Fed to swing back to interest rate cuts. And while oft-forgotten amongst the inflation headlines, we do not think the Fed will back off on QT, which should continue to drain a significant amount of liquidity from the broader financial markets throughout 2023, if not beyond. As a result, a prolonged Fed-induced rally driven by near-term monetary loosening is not part of our current thinking. Of course, we could be wrong in our assessment, or more likely, the weekly speculation on this topic from various market participants could drive increased volatility in both directions.

As it relates to a possible recession, we consider history to be as good of a guide as any. There have been nine recessions since the 1960s, and each one has been preceded by a yield curve inversion in which the yield on the 10-year Treasury Bond falls below that of the 2-year Treasury Note. On average, the onset of recession lags the initial inversion by just over a year. If this history were to repeat, there would be a good likelihood of recession sometime in the back half of 2023, based on an initial (and sustained) yield curve inversion in July 2022. With the average duration of a modern-day recession at just under a year, the next potential recession could last well into 2024. Typically, though, equity markets bottom about midway through recessionary conditions, suggesting a bottom late this year or early next. While history often rhymes and historical context is helpful, each cycle is, of course, different. So, while we employ pattern recognition and consider historical timelines helpful guides, we try always to remain flexible in our approach and thinking.

The impact of this macro framework is relatively modest as it relates to specific actions we are taking in the Fund. We think it is likely too early to add a material amount of long exposure to high growth names, though we have put a toe in the water in a few names such as B2B payments provider Bill.com, which holds a strong market position, is growing rapidly while profitable, and is down some 75% from its prior highs. Even though many such names are down as much or more, we believe fundamental deterioration lies ahead for most companies, and far too many remain unprofitable, thus rendering them relatively unattractive within our investment framework.

Broadly, we believe a good time to put more capital to work and take more risk is when fundamentals have bottomed, sentiment is poor, valuations are cheap, and monetary policy is poised to no longer be restrictive. Entering 2023, none of these conditions are firmly in place, in our view. However, we monitor these inputs regularly, and we believe things could potentially line up more favorably at some point during this year. The environment can change quickly, as we saw in 2022, and we remain attuned to shifting winds and prepared to tack to take advantage of opportunities as they present themselves.

We wish you all a safe and healthy start to 2023 and look forward to sharing another update mid-year.

Respectfully,

Joe Milano

Baird Equity Opportunity Fund (2022)

PERFORMANCE

Periods Ending December 31, 2022[1] (%)	Total Return (%)	Average Annual Total Returns (%)				Expense Ratios (Net/Gross)[2]
	QTR	1 Year	3 Year	5 Year	Since Inception (05/01/2012)	
Baird Equity Opportunity Fund Institutional Class (BSVIX)	9.41	-11.56	2.79	1.45	6.78	1.25 / 1.90
Baird Equity Opportunity Fund Investor Class (BSVSX)	9.28	-11.77	2.53	1.20	6.52	1.50 / 2.15
Russell 2000 Index®	6.23	-20.44	3.10	4.13	8.93	

[1]Performance data represents past performance and does not guarantee future results. Returns over one year are annualized unless specified. The investment return and principal value of the investment will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the data quoted. Performance figures assume reinvestment of all dividends and capital gains. For performance data as of the most recent month-end, please visit bairdfunds.com. *Investors should consider the investment objectives, risks, charges and expenses of the fund carefully before investing. This and other information can be found in the prospectus or summary prospectus. A prospectus or summary prospectus may be obtained by visiting bairdfunds.com. Please read the prospectus or summary prospectus carefully before investing.* Fund performance is net of fees.

[2]The Net Expense Ratio is the Gross Expense Ratio minus any reimbursement from the advisor. The advisor has contractually agreed to waive its fees and/or reimburse expenses at least through April 30, 2025, to the extent necessary to ensure that the total operating expenses do not exceed 1.50% of the Investor Class's average daily net assets and 1.25% of the Institutional Class's average daily net assets.

TOP & BOTTOM CONTRIBUTORS

Top 5 Portfolio Contributors	Avg. Weight	Contribution
EVO Payments, Inc. (EVOP)	4.69	2.58
Valmont Industries, Inc. (VMI)	4.62	1.72
Zynga Inc. (ZNGA)	2.52	1.17
Oceaneering International, Inc. (OII)	0.72	1.02
Fluor Corporation (FLR)	2.29	0.68

Bottom 5 Portfolio Contributors	Avg. Weight	Contribution
Green Dot Corporation (GDOT)	1.56	-1.29
Tuesday Morning Corporation (TUEM)	0.47	-1.54
Infinera Corporation (INFN)	4.05	-1.55
Vista Outdoor Inc (VSTO)	2.72	-1.67
Clarus Corporation (CLAR)	3.79	-4.31

Investment Professional	Years of Experience	Team Since	Coverage Responsibility
Joe Milano, CFA Portfolio Manager	26	2013	Generalist
Chip Morris, CFA Analyst	36	2014	Technology
Scott Barry Analyst	26	2014	Consumer Discretionary & Staples
Ben Landy Analyst	14	2014	Industrials & Materials
Scott Mafale Analyst	7	2021	Healthcare

This commentary represents portfolio management views and fund holdings as of 12/31/22. Those views and fund holdings are subject to change without notice. The performance of any single fund holding is no indication of the performance of other holdings of the Baird Equity Opportunity Fund. Past performance is no guarantee of future results.

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.

Prior to December 12, 2021, the fund was managed in accordance with a different investment strategy. The Subadvisor became the Fund's subadvisor effective December 12, 2021. The performance results shown are from periods during which the Fund was managed by the Advisor prior to the retention of a Subadvisor.

As a non-diversified fund, the fund may invest a larger percentage of its assets in a smaller number of companies compared to a diversified fund, which increases risk and volatility because each investment has a greater effect on the overall performance. The fund focuses on small- and mid-cap stocks and therefore the performance of the fund may be more volatile, less liquid and more likely to be adversely affected by poor economic or market conditions than investments in larger companies. The fund may invest up to 15% of its total assets in the equity securities of foreign companies. Foreign investments involve additional risks such as currency rate fluctuations, the potential for political and economic instability, and different and sometimes less strict financial reporting standards and regulation.

The Russell 2000 is the most widely quoted measure of the overall performance of small-cap to mid-cap stocks. It represents approximately 10% of the total Russell 3000 market capitalization. It is made up of the bottom two-thirds in company size of the Russell 3000 index.

Baird Funds are offered through Robert W. Baird & Co., a registered broker/dealer, member NYSE and SIPC. Robert W. Baird & Co. also serves as investment advisor for the Fund and receives compensation for these services as disclosed in the current prospectus.

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