Fighting FOMO This Year Might Require a Return to International Markets

Baird Funds

As a motivation for investors, the fear of missing out (FOMO) was a powerful driver of flows into U.S. equities—until stocks headed south in 2022, with the S&P 500 Index ultimately ending the year down 19%. Markets move and things change. Now FOMO could be what's behind the most informed investors' heightened interest in international equities.

Are financial advisors ready to turn their sights on markets they haven't considered for years? Even more important, will clients get on board? Every investment professional understands the argument for diversification—what Harry Markowitz called the "only free lunch in finance." But U.S. stocks have dominated for 10 years, and those with portfolios biased toward the S&P 500 outperformed the MSCI ACWI ex-U.S. Index by almost 200% over the course of the last decade. The three brief periods when the MSCI ACWI ex-U.S. Index outperformed the S&P 500 were times when the dollar weakened. The temptation may be to weather the storm stateside, based on the expectation that good times will return again soon.

Below we provide four reasons—including some updates to challenge that thinking, and to re-allocate in a way that will prevent you or your clients from missing out on what could be setting up as a multi-year period of international equity outperformance.

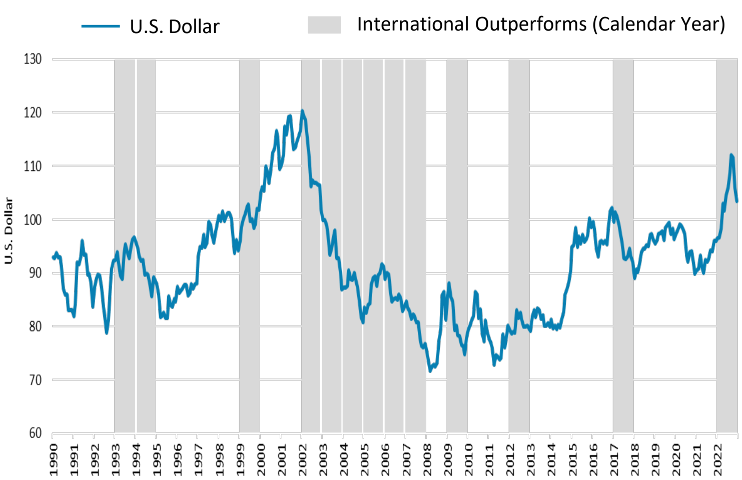
DON'T MISS OUT WHEN ATTRACTIVELY PRICED STOCKS START TO RUN

Given starting point valuations and the valuation differential between U.S. and international markets, the case for international investing may have never been stronger.

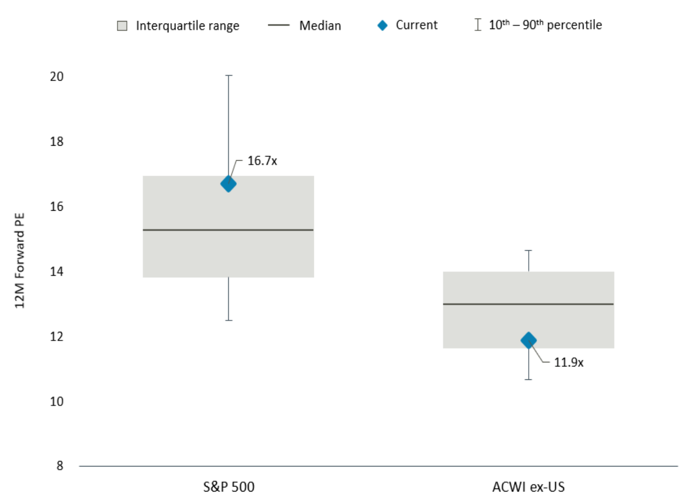
Cycles of U.S. and international leadership tend to be long. Prior to the U.S. dominance starting in 2012 was a comparably long period of international outperformance in the 2000s, as shown in the chart below. An even longer view would show non-U.S. markets led for several years in the 1980s and the 1970s. With international equities relative underperformance again approaching historical extremes in both duration and magnitude, we believe non-U.S. stocks are due to reclaim market leadership.

There's a strong link between starting valuations and subsequent long-term returns. The last time such similar extremes were seen in relative valuations was at the early stages of international outperformance in the 2000s.

U.S. Dollar Strength vs. Calendar Year Relative Returns
(MSCI ACWI ex-U.S. Index – S&P 500 Index)



Valuation Ranges for S&P 500 and MSCI ACWI ex-U.S.
(Monthly Rolling 12-Month Forward P/E, over 10 years)



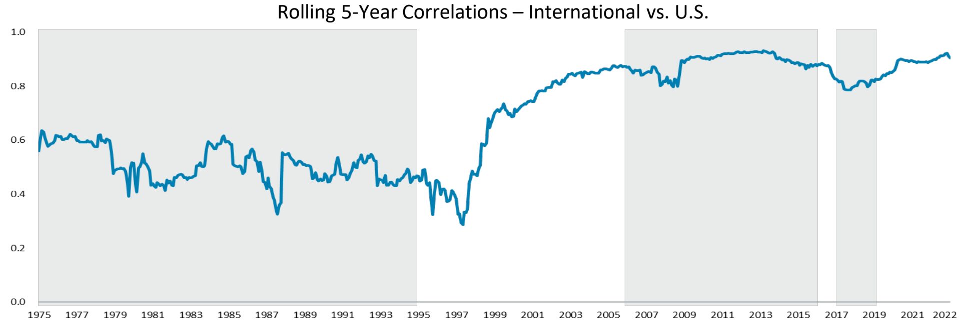
Source: Bloomberg
Data as of 12/31/2022
Sources: FactSet, eVestment
U.S. Dollar value determined by the ICE U.S. Dollar Index - Price.
Calendar years outperformance and percentage outperformance (cumulative) calculated using MSCI ACWI ex-U.S. Index versus. S&P 500 Index.

IN A DEGLOBALIZED WORLD, NON-U.S. EXPOSURE PROVIDES ADDED DIVERSIFICATION

After 2022's market volatility, an allocation to international has the potential to take the edge off. Studies (Vanguard, 2021) have shown that international allocations up to 40% can reduce volatility by as much as 10% versus. an all-U.S. equity portfolio. That has been the case. Here's what's changing to further strengthen our belief of the benefits to international exposure: Recent history has seen world economies move toward globalization only to back off from it.

The chart below shows peak globalization in 2016, the year the United Kingdom voted to leave the European Union. The years since then have been characterized by trade wars and the associated rise of economic nationalism and corresponding barriers to cross-border movement of capital and labor, as well as fragmentation of global supply chains.

Further Declines in Globalization will Strengthen the Case for International Diversification
Rolling 5-Year Correlations – International vs. U.S.



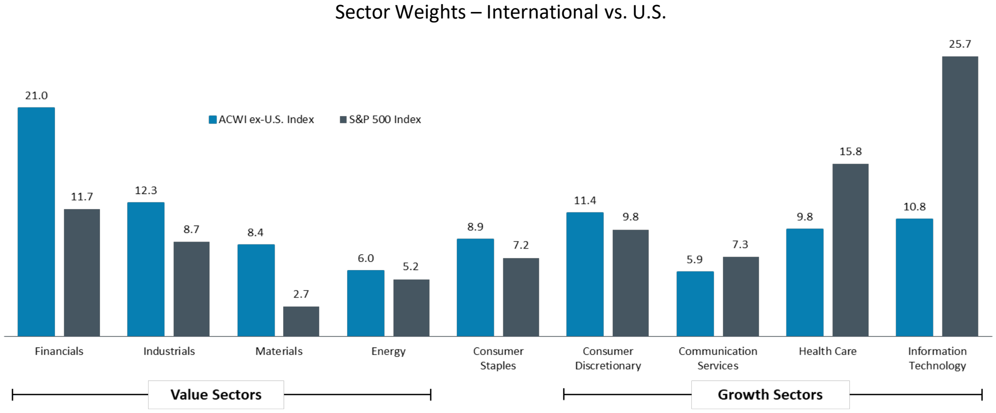
- Pre-WTO (1975 – 1995): 0.50
- Peak Globalization (2006 – 2016): 0.90
- Post-Globalization (2017 – 2019): 0.82

RIGHT TIME—AND THE RIGHT PLACE

FOMO afflicts those who are not in the right place at the right time. If you're accustomed to using passive investments for broad market exposure, you may want to think twice about using that approach with international markets. For most growth-minded investors, investments pegged to growth-oriented international indices are not the right place.

There's a significant difference between U.S. and international benchmarks, as shown in the comparison below to the ACWI ex-U.S. Index and the S&P 500. Compared to the U.S. benchmark, the international index is significantly overweight traditional "value" sectors facing long-term structural and macroeconomic headwinds and underweight "growth" sectors. International indices underweight to IT, Health Care and Communication Services accounts for more than half of the underperformance of international markets over the past several years. We believe that bottom-up, fundamental research of individual companies is a better way to uncover attractive non-U.S. investments (see sidebar).

International Indices are Overweight Value, Underweight Growth
Sector Weights – International vs. U.S.



Source: Bloomberg, MSCI, Standard & Poor's
International represented by MSCI World ex-U.S. Index and U.S. represented by S&P 500 Index. Sector exposure (%) provided as of 12/31/2022.

CONVICTION DRIVES CHAUTAUQUA 'BEST IDEAS'

Different political regimes, different currencies, differentiated types of companies and elevated growth rates in non-U.S. countries all create a rich opportunity for skilled active managers.

The Chautauqua Capital Management team follows a disciplined investment process that considers growth, profitability and valuation metrics. The team's secret sauce is a process of asking questions that instill objectivity and result in a portfolio designed to capture superior upside performance while limiting downside capture. Companies that meet the team's criteria are very difficult to find, which explains the funds' long investment horizon and low turnover.

<u>The Chautauqua "best ideas" Funds:</u>

Baird Chautauqua Global Growth (CCGIX)

Baird Chautauqua International Growth (CCWIX)

INVESTMENT TEAM

Jesse Flores, CFA
Chautauqua Partner
Industry Years: 17 | Fund Since: 2016

Haicheng Li, CFA
Chautauqua Managing Partner
Industry Years: 22 | Fund Since: 2016

David Lubchenco
Chautauqua Partner
Industry Years: 31 | Fund Since: 2016

Nate Velarde
Chautauqua Partner
Industry Years: 22 | Fund Since: 2019

CHAUTAUQUA CAPITAL: "STOCK SELECTION DRIVES RETURNS"

Based on current index sector data as shown above, international indices are not representative of the growth opportunities that exist outside of the U.S. We believe that in-depth fundamental analysis on a company-by-company basis is a much better way to uncover great wealth generating companies that are domiciled outside of the U.S..

Chautauqua's investment philosophy and process is deployed to construct funds comprised of such companies that benefit from long-term secular trends and possess the business model advantage. We take great care as we apply quality criteria, evaluate macro economic forces and apply proprietary forward looking valuation criteria. The result of our investment approach has been relative outperformance since inception versus. stated benchmarks for our funds.

CONTACT U.S.

For full detail on recommended portfolio allocations, including expected returns and standard deviations, please contact Jarred Schmitz at jschmitz@rwbaird.com.

FUND PERFORMANCE *(as of 6/30/2023)*

	Total Return (%)		Average Annual Total Returns (%)			
	QTR	YTD	1 Year	3 Year	5 Year	Since Inception (4/15/2016)
International Growth Fund Institutional Class (net)	0.24	12.05	16.96	9.55	7.52	9.21
International Growth Fund Investor Class (net)	0.18	11.91	16.74	9.25	7.23	8.93
MSCI ACWI ex-U.S. Index - ND	2.44	9.47	12.72	7.22	3.52	5.77
Global Growth Fund Institutional Class (net)	2.31	11.88	16.74	9.40	8.94	11.20
Global Growth Fund Investor Class (net)	2.23	11.73	16.42	9.09	8.72	10.95
MSCI ACWI Index - ND	6.18	13.93	16.53	10.99	8.10	9.57

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.

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.

The Fund may hold fewer securities than other diversified funds, which increases the risk and volatility because each investment has a greater effect on the overall performance. Foreign investments involve additional risks such as currency rate fluctuations and the potential for political and economic instability, and different and sometimes less strict financial reporting standards and regulations.

The MSCI ACWI Index® is a free float-adjusted market capitalization weighted index that is designed to represent performance of the full opportunity set of large- and mid-cap stocks across 23 developed and 24 emerging markets, including the United States. Indexes are unmanaged and direct investment is not possible. "ND" represents net of dividends returns for the benchmark.