



Baird Investment  
Management

*From Baird Investment Management's  
Value Investment Team:*

## Small/Mid Value 2<sup>nd</sup> Quarter 2015

### Portfolio Commentary

U.S. equities, as represented by the S&P 500, ended the quarter (2063) almost where it began (2067). Investors continue to hinge on every word of the Federal Reserve in hopes of understanding when a healthy macro economy might support the first interest rate hike since 2006. In the meantime, both China and Europe continue very accommodative monetary and fiscal policies in hopes of combating deflationary fears of falling demand and inventory builds.

The Baird Small/Mid Cap Value Portfolio delivered an absolute return of 2.48% outperforming the benchmark Russell 2500 Value by 375 basis points. The Portfolio continues to deliver solid long-term absolute and relative returns outpacing the benchmark on an annualized basis by 980 bps for the trailing 1-yr, 300 bps for the trailing 3-yr, 310 bps trailing 5-yr and 300 bps trailing 10-yr periods.

For the quarter, performance was predominantly driven by our financial and information technology holdings. Financials provided the largest source of outperformance in the quarter (250 bps), despite a nearly 1100 bps underweight in the sector. Our financial stocks produced a positive return of 8.3% while the benchmark lost nearly 1%. Bank holdings paced the financials outperformance, led by Hilltop Holdings, Bank of the Internet and Private Bancorp. HCC Insurance jumped 36% on a takeout offer by Tokio Marine. Our overweight position in semiconductor manufacturers with exposure to secular growth in mobile data growth and the Internet of Things continued to contribute to returns. Integrated Device Technology, Atmel, and Synaptics were among the top contributors. Additional top performers include Dorian LPG Ltd and Pinnacle Foods.

Real estate investment trust stocks with sensitivity to rising interest rates and industrial holdings with foreign sales or U.S. Dollar exposure declined due in part to forecasts for declining international sales. Individual positions that lagged during the quarter include Lands' End (LE), Generac Holdings (GNRC), Harman International (HAR), and Universal Truckload Services (UACL).

Michelle E. Stevens, CFA  
*Senior Portfolio Manager*

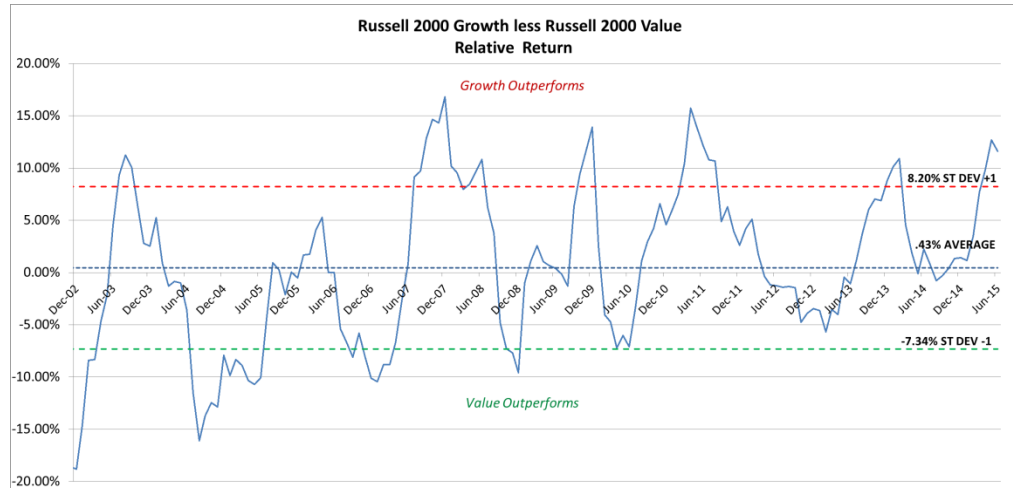
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*Senior Marketing Specialist*

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*Trading & Operations Analyst*

During the quarter we exited Methode Electronics (MEI) and trimmed our position in Skyworks Solutions (SWKS). Conversely, we initiated positions in Qorvo Incorporated (QRVO) and Diamond Resorts (DRII).



The chart above represents a historical view of the rolling 12 month returns of small cap growth compared to small cap value stocks since late 2002. This chart illustrates that performance tends to oscillate between growth and value stocks over time with observable peaks and valleys that at their extreme, are usually short lived. During the 1<sup>st</sup> half of 2015 this relationship moved from near historical averages to levels clearly favoring growth investors by the end of 2<sup>nd</sup> quarter. Intuitively, growth investing tends to outperform value investing during times of perceived growth scarcity. This coincides with the current domestic economy still struggling to keep up with expectations, a point we highlighted in our last commentary.

*“Our concerns about weakness in economic growth outside the United States continue to be validated by recent economic data and the consequent impact on multinational equities has been increasingly reflected in downward revisions to earnings estimates. We expect the strong U.S. dollar and decelerating global growth will be headwinds for large multinational companies but plays to the strength of domestic small companies with less than half the exposure to foreign revenue.”*

On April 29<sup>th</sup>, the Bureau of Economic Analysis reported an advanced GDP growth rate of just 0.2% for the latest quarter falling well short of 1% estimates. Further, the second estimate released late May reported an even lower -0.7% based upon more complete information. So too, the Federal Reserve responded in kind, with no change to monetary policy and the date of the first hike pushed out further into the future.

At this juncture, however, the chart above appears to indicate this current trend of growth over value has likely run its course, and as the most recent data points seem to indicate, value investing may be gaining favor over growth. Year-to-date returns also signal a return to small cap stocks outperforming large cap, a reversal from 2014.

As we look to the second half of the year, we continue to see strength in the U.S. consumer, who has seen hours worked increase, incremental job growth, and higher disposable income translating into near peak auto sales and strong housing starts. Contrary to popular sentiment, however, we expect the weakness in domestic energy markets to continue to be a net drag on economic growth as spending cuts have been more deep and swift than the corresponding positive impact of lower energy prices. In addition, we remain skeptical of consensus GDP expectations outside the U.S., specifically for the EU and China. These observations keep the portfolio biased to domestic revenue sources, consumer-oriented holdings, and financials. As always, we will seek to mitigate risk by maintaining a well-diversified portfolio of businesses, which we project can exceed growth expectations and which trade at compelling valuations. This strategy, we believe, when applied with discipline, yields attractive long-term returns for investors.

Thank you for your continued support and partnership.

Michelle E. Stevens, CFA

Portfolio Manager

**The Baird Investment Management Small/Mid Value commentary is incomplete if not accompanied with the most recent performance report.**

The Russell 2500 Value Index measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2500 Index companies with lower price-to-book ratios and lower forecasted growth values. The Russell Indices are a trademark of the Frank Russell Company.

The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the NASDAQ.

Indices are unmanaged and direct investment is not possible. Past performance is no guarantee of future results.

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## Tenured Small/Mid Cap Value Investment Team

- 20 Years – Average Experience
- Long-Term Team Continuity

Investment Professional	Years of Experience	Investment Team Since	Coverage Responsibility	Educational Background
<b>Michelle E. Stevens, CFA</b> <i>Managing Director, Senior Portfolio Manager</i>	22	2000	Consumer Staples Energy Producer Durables REITS	MBA – (U. Cincinnati) BA – Economics (Wittenberg University)
<b>Richard B. Roesch, CFA</b> <i>Vice President Investment Analyst</i>	22	2004	Banks Consumer Discretionary Healthcare Technology	BS – Finance (Butler University)
<b>Jonathan DeMoss, CFA, CPA, CFP</b> <i>Vice President Investment Analyst</i>	19	2005	Auto & Transports Insurance Materials & Processes Utilities	MBA –(Indiana University) BA – Accounting/Management (Iowa State University)
<b>Rob Zwiebel</b> <i>Senior Vice President Senior Marketing Specialist</i>	24	2004	n/a	BS – Finance (University of Dayton)
<b>Jesse Parsons</b> <i>Trading &amp; Operations Analyst</i>	10	2012	n/a	BBA – Finance/Marketing (University of Kentucky)