From Baird Investment Management's Mid Cap Growth Equity Investment Team:

Mid Cap Growth Equity 4th Quarter 2015

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Market Update

Following a third quarter besieged by currency devaluations, global growth fears and an uncertain view of Federal Reserve policy, investors braced for a continuation of choppy markets into year-end. Equity markets lifted nicely during the fourth quarter with most of the positive work done in October. December brought on more volatility as investors digested choppy economic activity, the first interest rate increase in nearly a decade and the market relied on a narrowing group of companies to advance, which left little room for error.

Portfolio Commentary

Clients of the Baird Mid Cap Growth portfolio began the quarter a bit ahead of the primary benchmark, the Russell® Mid Cap Growth index, but sharp negative price action in a handful of long-held stocks hurt performance in the fourth quarter and put a damper on the year. Specifically, reported earnings disappointments, one each in healthcare, industrials and technology, and two in consumer cumulatively reduced performance by over 200 basis points. The outcome was flat results for the quarter and low single digit declines for the year.

During the first three quarters of the year, it became increasingly apparent that global economies were being pressured by low commodity prices, weak end markets and slowing earnings growth. During the year, substantial work was done within the portfolio to reduce cyclicality, namely lowering weight in manufacturing, energy and, in some cases, businesses with outsized foreign exposure. Additionally, the consumer discretionary sector, following several years of meaningful gains and higher valuations, was trimmed back. This harvesting of gains continues to be an important part of our long term investment strategy of balancing risk and reward. Capital flowed into less cyclical, mostly domestic businesses that possess the return profile and balance sheet standards we admire. As a result, our portfolio is balanced across sectors and more defensive than in prior years. Our sector thoughts and a description of portfolio changes follow.

The materials sector provided the portfolio's largest relative contribution in the fourth quarter, continuing a trend that held throughout the year. Outperformance from Acuity Brands, which specializes in commercial lighting solutions, was a key driver as the company continues to deliver strong earnings growth. Furthermore, the announced acquisition of long-time holding Airgas by Air Liquide, lifted the stock sharply. While happy to reap the short-term benefits of a takeout, there is a trade-off in losing a very good business that has added value to the portfolio over time. With the sale of Airgas following the deal announcement and a trim of Acuity, the portfolio enters 2016 modestly underweight the sector.

After three solid quarters, the technology sector lagged as holdings in the software and services industry produced a negative return in an up quarter for the sector. Fortinet and Akamai both suffered meaningful price declines following the release of quarterly results, which included guidance short of expectations. On a positive note, the semiconductor industry continued to serve as an area of outperformance. Most notably, Integrated Device Technology and the anticipation of growing demand for its wireless charging solutions led to strong price performance. Changes were relatively modest and included an addition to the CDW position and trims of Ultimate Software and Fortinet, which in hindsight was not large enough given the price decline referenced above. The portfolio remains in a modest overweight position with good end market diversification. Despite the sluggish economic environment, we believe the sector offers plenty of good secular growth opportunities.

The consumer discretionary sector, a leader most of the year, struggled on a relative basis. Negative reactions to softer reported earnings out of Polaris Industries, a maker of power sport vehicles, and restaurant Buffalo Wild Wings hurt. In addition, Burlington Stores pulled back rather sharply on concerns that warm weather at the beginning of winter would significantly slow seasonal sales; a situation we believe will prove temporary. Regarding sector changes, we purchased a position in Dollar General, a former holding with a strong history of executing in the low-priced retail segment, and we had the unusual situation of buying and then selling Chipotle within the same quarter. The unfortunate news of an E. coli outbreak in several of the company's locations derailed our thesis. We also added Lions Gate, which provides exposure to consumer entertainment spending as a well-managed producer and distributor of motion picture and television content. We took a fair amount of weight out of the sector in recent months, selling Sally Beauty and trimming several other holdings, particularly in specialty retail, and finished the year underweight. We think the backdrop for consumer spending generally remains favorable due to continued job growth, signs of wage inflation, and low energy costs, but we are also increasingly mindful of the meaningful duration of outperformance among key industries in the sector.

The energy sector was generally a non-factor for the portfolio during the quarter. Given the drop in sector weight due to the combination of changes in the benchmark at mid-year and poor sector performance, energy currently represents a one-stock sector for the portfolio.

Healthcare stocks delivered the portfolio's largest relative underperformance. The healthcare services industry suffered the most as Envision Healthcare declined sharply on unexpected revenue softness reported with quarterly results. Perrigo, a large portfolio holding, felt the negative effects of fending off an unwanted takeover attempt by Mylan. We agreed that a combination with Mylan represented a bad buyer offering an inadequate price, however, the offer did serve to provide some support during a volatile fall for many healthcare stocks. It has been a difficult two years for performance in this sector. Our overall strategy of investing to obtain exposure to multiple end markets and working to identify companies down the market cap spectrum that provide long growth opportunities has not worked. Certainly, mistakes have been made, but our focus on profitability has limited the opportunity set in this sector as the strongest performance was often found in many higher risk biotech and pharmaceutical companies. We do not plan to compromise key tenets of our investment philosophy and will continue to seek attractive growth businesses.

Holdings in the consumer staples sector trailed benchmark performance primarily due to the food industry, which was hurt by a decline in United Natural Foods. The company, which is a leading distributor of natural and organic foods, struggled on concerns over end market growth at companies like Whole Foods (a large United customer). We continued to seek opportunity in the sector but the growth/valuation trade off looks out of balance to us as strong performance in the sector in recent years has led to relatively high valuations for modest growth. We did initiate a position in Constellation Brands, the largest multi-category supplier of alcoholic beverages in the U.S. Faster growth in the company's Mexican beer business is positively changing the long-term composition of the business model, and should lead to higher returns.

The producer durables sector gave back some ground on a relative basis as the softer global growth picture challenged the outlook for manufacturing related businesses. Broadly, the sector was able to shake off economic growth concerns and outperform the growth index. However, within the portfolio, solid performance from several companies, most notably by A.O. Smith (manufacturer of water heaters), was offset by declines in Wabtec (rail and transit part manufacturer) and Stericycle (medical waste disposal). In many ways, Stericycle characterized the severe nature of the market during the quarter as the stock declined 20% following its third quarter earnings release, something we had not seen in many years of owning this stable, well-managed business. While we will continue to scrutinize whether something within the business has truly changed, we added to the position on the weakness. We also purchased a new position in Snap-On, which manufacturers specialty tools and diagnostic and repair systems for professional repair and construction. We like the company's consistent growth, product innovation, reputation and potential for long-term foreign expansion. To make room for the previous moves, we trimmed Rockwell and J.B. Hunt, reflecting the more challenging economic growth picture.

Financial services lagged for the second straight quarter. The volatile market environment kept long interest rates low, despite action by the Fed, which enabled REITs to continue their advance. In addition performance from the portfolio's asset manager holdings hurt, primarily due to Affiliated Managers Group, which experienced a tougher fund flow environment. Changes made to the sector included adding to Alliance Data Systems and Northern Trust as well as buying a position in Euronet Worldwide, and selling the remaining piece of Greenhill. Euronet lifts the portfolio weight in the financial and data processing industry. The company, led by its founder, provides electronic payment services such as money transfer in a partnership with Wal-Mart, foreign ATM management and servicing, and other mobile and prepaid transaction services.

Outlook

We begin 2016 much as we did a year ago – worrying about the pace of U.S. economic growth, a possible Chinese recession, energy prices, corporate profits, etc. When we layer in the future path for interest rates, the outcome of November's presidential election and uncertain earnings growth in 2016, it is quite easy to be bearish. Recognizing higher uncertainty and potential risks, we have positioned our portfolios to be more defensive than in prior years.

There are, however, both bright spots and potential changes that require a balanced view towards the equity markets. Employment trends, and importantly wages, continue to rise giving the Federal Reserve the support needed to begin normalizing interest rates. Record levels of merger and acquisition activity reflect business confidence and both residential and non-residential construction markets are performing well. There is anecdotal evidence that Europe is finding its economic footing. Additionally, the Chinese central bank and government have become more aggressive in fighting the slowdown in their economy which, if successful, should reduce a significant market overhang.

The tone for the first quarter is likely to be established in January, as companies begin reporting earnings for the calendar fourth quarter and providing their outlook for the New Year. As earnings multiples have contracted in many areas and given the negative sentiment and disappointing performance of most stocks last year, in-line guidance may be good enough to reverse the downtrend. We will adjust as our fundamental work on companies dictates.

On behalf of everyone at Baird Investment Management, we thank you for your support of our Mid Cap Growth strategy and wish you a very happy and prosperous New Year.

The Baird Investment Management Mid Cap Growth Equity commentary is incomplete if not accompanied with the most recent performance report.

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Tenured Mid Cap Growth Investment Team

- All investment team members have equity ownership
- Deep sector expertise
- Average years of experience: 18 years

Investment Professional	Years of Experience	Years with Baird	Coverage Responsibility	Educational Background
Chuck Severson, CFA *Senior Portfolio Manager and Analyst*	29	28	Industrials & Materials Consumer Discretionary - Auto	MS – Finance - The Applied Security Analysis Program BBA – Accounting and Finance (UW – Madison)
Ken Hemauer, CFA *Senior Portfolio Manager and Analyst*	22	21	Financial Services Consumer Discretionary IT-Business Services	MS – Finance - The Applied Security Analysis Program BBA – Finance (UW – Madison)
Doug Guffy *Senior Research Analyst*	32	11	Energy & Industrials	MBA – Finance (Ball State University) BA – Economics & Government (Anderson University)
Jonathan Good *Senior Research Analyst*	16	9	Healthcare Information Technology	MBA – (Northwestern University – Kellogg) BS – Applied and Biomedical Sciences (Pennsylvania)
Chaitanya Yaramada, CFA *Senior Research Analyst*	6	6	Information Technology-Software	MBA (University of Chicago-Booth School of Business) BE – Bachelor of Engineering-Software (Univ. of Auckland, New Zealand)
Corbin Weyer, CFA, CPA *Research Analyst*	5	5	Consumer	BSBA – Finance & Accounting (Marquette University)