



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

Small/Mid Value & Small Value 4th Quarter 2015

Fear...Anxiety...Denial....Panic....Capitulation

Major stock market indices enjoyed a reprieve from the late summer market swoon that had been precipitated by weakness in emerging markets, particularly China. Large cap and growth stocks were the big winners in the quarter as investors flocked to companies perceived to have the ability to grow in a slowing economic environment. The recovery was incredibly narrow, however. In fact, more than 50% of the stocks in the Russell 3000 Index finished the year 20% or more below their 52-week high. In addition, many commodity prices continued their decline with oil falling to lows not seen since 2008.

As you may recall from last quarter's commentary, beginning in July of 2015, we became increasingly concerned about the macroeconomic backdrop. In fact, we stated:

"it was the move on August 11 by the People's Bank of China to devalue the yuan by nearly 2% against the US dollar that, in our minds, waved the red flag..."

"As a result, we felt it prudent to reassess our holdings in light of the potential for a meaningful slowdown beyond current expectations for Chinese and global growth. This potential environment could lead to another leg down in energy markets and ultimately have a negative impact on domestic growth, as well."

With a watchful eye, we have been monitoring the trend in U.S. economic indicators for signs that deteriorating global growth along with stressed conditions in emerging market currencies and credit markets have begun to impact domestic activity. Weak industrial production data and regional economic surveys, deteriorating transportation trends, and disappointing retail sales during the fourth quarter raised enough uncertainty in our estimation to prompt additional changes to the portfolio in order to provide downside protection. Furthermore, now that oil has made a second leg down in price, we know that this will further pinch capital spending along with secondary and tertiary related industries domestically.

These changes in trend for many economic and monetary conditions have not been fully reflected in consensus GDP and earnings estimates and present risk to equities exposed to a slowdown.

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Baird Small/Mid Value Portfolio

The Baird Small/Mid Value Portfolio posted a return of -0.1% for the quarter versus a 2.8% return for the benchmark Russell 2500 Value. For the year, the Small/Mid Value Portfolio significantly outperformed the benchmark gaining 0.1% versus a -5.5% return for the Russell 2500 Value. The Portfolio did not fully participate in the low quality advance during the final quarter of the year, nonetheless, enjoyed strong performance for 2015. Superior security selection among 9 out of 10 economic sectors was primarily responsible for calendar year outperformance.

Portfolio trading during the quarter was focused on reducing exposure to companies with earnings risk related to a slowing economic environment. We exited Lands' End, and Knight Transportation given the record warm temperatures which we expected could exasperate weak trends for retail spending. We also sold Encore Capital Group and Teekay Shipping due to a deteriorating credit environment and falling crude oil demand, respectively.

The proceeds from these sales were invested in both new positions and additions to existing holdings. Less economically sensitive sectors such as utilities, consumer staples, and healthcare absorbed the majority of the proceeds. All three sectors looked attractive given a pullback during the fourth quarter.

Underperformers for the quarter included Financials, weighted down by weakness in debt collectors and Bank of the Internet. Industrials and Healthcare also underperformed primarily due to downward earnings revisions for Ryder, Teekay and Alere. Information Technology was the best performing sector for the quarter led by strong gains for Integrated Device Technology, J2 Global, and Verisign. Orchids Paper Products, a new position last quarter, led the Materials sector to strong gains for the period.

Baird Small Value Portfolio

The Baird Small Value Portfolio posted a return of -0.3% for the quarter versus a 2.9% return for the benchmark Russell 2000 Value. For the year, the Small Value Portfolio significantly outperformed the benchmark returning -4.0% versus a -7.5% return for the Russell 2000 Value. The Portfolio did not fully participate in the low quality advance during the final quarter of the year, nonetheless, enjoyed strong performance for 2015. Strong security selection among 9 out of 10 economic sectors was primarily responsible for calendar year outperformance.

Portfolio trading during the quarter was focused on reducing exposure to companies with earnings risk related to a slowing economic environment. We

exited Lands' End, and Knight Transportation given the record warm temperatures which we expected could exasperate weak trends for retail spending. We also sold Quanta Services due weakening end demand for their offerings.

The proceeds from these sales were invested both new positions and additions to existing holdings. Less economically sensitive sectors such as utilities, consumer staples and financials absorbed the majority of the proceeds. All three sectors looked attractive given a pullback during the fourth quarter.

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Looking Forward

"Delay is the deadliest form of Denial" -C. Parkinson

With this in mind, and given the low quality, narrow fourth quarter market advance; rising investment grade credit spreads; emerging market currency devaluations; and slowing global economic growth we believe the portfolios are well positioned entering 2016.

Thank you for your continued support and partnership.

Michelle E. Stevens, CFA

Portfolio Manager

The Baird Investment Management Small/Mid Value and Small 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.

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

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