



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

Small/Mid Value 1st Quarter 2014

Portfolio Commentary

Sam Zell's February appearance on CNBC's Squawk Box alongside guest host St. Louis Federal Reserve Governor Bullard made a point regarding quantitative easing (QE) and its effect on corporate decision making *or the lack thereof*. He argued the perception of continued easy money policy by the Fed inhibits corporate decision makers from making economic decisions in the near term and instead gives them an incentive to wait for additional information (Is the economy getting better or not? What's our six month sales forecast? How much inventory do we have on hand if sales increase?). Clearly that's not the way the Federal Reserve interprets corporate decision making. Rather, their intent was to do the opposite – make the cost of funds so low and liquidity ubiquitous, every project has a positive NPV and therefore approved.

But according to game theory, the Governors shouldn't have been so surprised by the reaction of C-suite executives. In fact, they acted exactly as they should have, namely, in a rational manner with the intent to maximize shareholder utility by delaying decision making.

As Mr. Zell illustrated, by giving market participants plenty of visibility as to the future of monetary policy, capital allocation decisions were converted from a simultaneous game into a sequential game. In a simultaneous capital allocation game, all participants act in their own interest without the knowledge benefit (or detriment) of other participant decisions. Meaning, because decision makers normally never know the next Fed move, time is fleeting and a decision to postpone, to see what others might do, is not possible.

An easing and transparent Fed, though, converts the game to a sequential one. Namely, time becomes irrelevant and knowledge of how the market moves becomes paramount. Imagine now, if this was done on a global scale - everyone waiting to see the capital allocation move of everyone else. Does the absolute level of interest rates or liquidity in the market even matter at that point?

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Now that the Fed has begun the tapering process and presumably on the road to a normalized interest rate environment, contrary information is being absorbed into the marketplace. The more the Fed sticks to the script, the more plausible the information becomes to observers. We could be seeing early indications that time and interest rates are fleeting - the game could quickly move from sequential back to simultaneous.

As noted beginning in our Q3 2013 performance report and reiterated in our Q4 2013 writings, we continue to look for more opportunities to position the portfolio towards a rebounding U.S. economy supportive of domestically oriented small cap companies.



The Baird small/mid value representative account delivered an absolute return of 3.48% during Q1 in line with the benchmark Russell 2500 Value performance of 3.52%.

During Q1 top sector contributors included Financials, Industrials, Energy, and Consumer Staples. Top individual contributors included Harman International (HAR), MasTec Incorporated (MTZ), Bank of the Internet (BOFI), Motorcar Parts of America (MPAA), and Omega Healthcare (OHI). Conversely, sector detractors included Information Technology and traditionally defensive Utilities and Health Care. Individual detractors included Himax Technologies (HIMX), recently sold Gamestop Corporation (GME) and Rent-a-Center Incorporated (RCII), Encore Capital Group (ECPG), and Air Methods (AIRM). During the quarter we took advantage of several opportunities to realize gains in positions which, fortunately, exceeded our expectations. In late January, we trimmed Air Methods (AIRM) and in early March sold roughly half our position in Bank of the Internet (BOFI). Other positions sold during the quarter included Sandridge Energy (SD), Winstream (WIN), CMS Energy (CMS), KBR Incorporated (KBR), and MYR Group (MYRG). During the quarter we initiated positions in Blackstone Mortgage (BXMT), Navigator Holdings (NVGS), PDC Energy (PDCE), Skyworks Solutions (SWKS), Texas Capital Bancshares (TCBI), and Private Bancorp (PVTB). Finally, we added to our existing position in Mastec Incorporated (MTZ).

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 S&P 500 Index is a representative sample of 500 leading companies in leading industries of the U.S. economy. The S&P 100 Index, a sub-set of the S&P 500®, measures the performance of large cap companies in the United States. The Index comprises 100 major, blue chip companies across multiple industry groups. The Dow Jones Composite Average Index is computed from the stock prices of 30 of the largest and most widely held public companies in the United States.

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Tenured Small/Mid Cap Value Investment Team

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

Investment Professional	Years of Experience	Investment Team Since	Coverage Responsibility	Educational Background
Michelle E. Stevens, CFA <i>Managing Director, Senior Portfolio Manager</i>	21	2000	Consumer Staples Energy Producer Durables REITS	MBA – (U. Cincinnati) BA – Economics (Wittenberg University)
Richard B. Roesch, CFA <i>Vice President Investment Analyst</i>	21	2004	Banks Consumer Discretionary Healthcare Technology	BS – Finance (Butler University)
Jonathan DeMoss, CFA, CPA, CFP <i>Vice President Investment Analyst</i>	18	2005	Auto & Transports Insurance Materials & Processes Utilities	MBA –(Indiana University) BA – Accounting/Management (Iowa State University)
Rob Zwiebel <i>Senior Vice President Senior Marketing Specialist</i>	23	2004	n/a	BS – Finance (University of Dayton)
Jesse Parsons <i>Trading & Operations Analyst</i>	9	2012	n/a	BBA – Finance/Marketing (University of Kentucky)