



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

Small Cap Value 2nd Quarter 2014

Portfolio Commentary

“Steady as she goes...” best describes our macro view of the U.S. economy juxtaposed to conditions at the business level which we believe are much improved from years past and consensus forecasts. Recent stock market highs, a low volatility index (VIX), and improved Institutes of Supply Management (ISM) data seem to validate our viewpoint - pay attention to the business trends and ignore the fog of exogenous events.



The Federal Reserve continues its monthly asset purchase tapering process. While actual increases in Federal Funds interest rates are still in the future, it's possible the Governors could be spooked by higher inflationary numbers mostly via an improving employment environment. Over the last several years many workers saw hours cut from full-time to part-time or accepted a job at a dramatically lower pay scale than what they were making previously. As the economy expands and companies hire workers, it is possible these previous trends could reverse course, resulting in temporary spikes to the data – something that may prompt the Fed to react.

A longer term counterweight to potential inflationary wage pressures would likely arrive in the form of energy price relief. While this July 4th holiday weekend marked one of the highest starts to gasoline prices for this year's summer driving season, increased domestic shale oil growth and greater fuel efficient vehicles could result in lower energy prices at the consumer level likely providing an additional boost to the economy as a whole.



For the quarter, the BIM Small Cap Value composite returned 1.53% while our benchmark Russell 2000 Value Index was up 2.38%. Performance was better than expected in April and June but underperformed in May. Year-to-date the composite increased 3.59% while the benchmark increased 4.20%.

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Performance for the quarter was led by our holdings in Information Technology, Energy, and Consumer Staples sectors. IT led all other sectors for the second month in a row with strength from hardware and equipment makers. Similarly, Energy reversed a weak April performance to post solid gains in both May and June. Leaders included Targa Resources Corporation (TRGP), Methode Electronics (MEI), Conn's Incorporated (CONN), Integrated Device Technology Incorporated (IDTI), and Quality Distribution (QLTY). In addition, Pinnacle Foods (PF) was also a strong contributor to results after receiving a strategic bid from Hillshire Brands. Conversely, just three out of ten benchmark sectors detracted from performance including Financials, Industrials, and Utilities. Utilities were down slightly in April and May but due to our underweighted position underperformed in the month of June as interest rates declined. Financials underperformed during the quarter despite a second best sector performance in April. May and June both saw negative pressure on bank stocks likely due to the back up in interest rates and fears of net interest margin compression. Lastly, Industrials suffered mightily during the second quarter finishing dead last each month. Individual positions that lagged during the quarter included Mastec Incorporated (MTZ), Generac Holdings (GNRC), Himax Technologies (HIMX), Universal Truckload Services (UACL), and Bank of the Internet (BOFI).

New additions to the portfolio during the quarter included: Methode Electronic (MEI), UIL Corporation (UIL), Triquint Semiconductor (TQNT), Integrated Device Technology Incorporated (IDTI), Hersha Hospitality (HT), Applied Optoelectronics (AAOI), Dorian LPG Limited (LPG), and Land's End (LE). Further, we added to our existing positions in Bank of the Internet (BOFI) and Willbros Group (WG). To make room for these new additions we exited Himax Technology (HIMX), Mid-America Apartment Communities (MAA), Rent-A-Center Incorporated (RCII), Air Methods Corporation (AIRM), Omega Healthcare (OHI), Hanesbrands (HBI), and Jarden Corporation (JAH).

Thank you for your continued support and partnership. As always, we welcome the opportunity to discuss further should you desire.

Michelle E. Stevens, CFA
Portfolio Manager

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

The Russell 2000 Value Index measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000 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 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>	20	2000	Consumer Staples Energy Producer Durables REITS	MBA – (U. Cincinnati) BA – Economics (Wittenberg University)
Richard B. Roesch, CFA <i>Vice President Investment Analyst</i>	20	2004	Banks Consumer Discretionary Healthcare Technology	BS – Finance (Butler University)
Jonathan DeMoss, CFA, CPA, CFP <i>Vice President Investment Analyst</i>	17	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>	22	2004	n/a	BS – Finance (University of Dayton)
Jesse Parsons <i>Trading & Operations Analyst</i>	8	2012	n/a	BBA – Finance/Marketing (University of Kentucky)