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

Baird Investment Management

Mid Cap Growth Equity
2nd Quarter 2014

Market Update

A confluence of unusual events challenged investors during the second quarter of 2014. Continued bad weather hampered domestic economic activity early in the period, long-term interest rates declined to the their lowest level in a year, significant price dislocation occurred especially in more aggressive issues, and additional turmoil emerged in the Middle East. However, as the quarter progressed, economic data found its footing, suggesting an improved growth outlook, which led to a more positive environment for equity returns.

Clients of Baird Mid Cap Growth portfolios lagged our primary benchmark, the Russell® Mid Cap Growth index for the period ending June 30. Absolute returns were approximately 1.2%, below that of the benchmark by roughly 3 percentage points.

Portfolio Commentary

As we began last quarter, we expected economic conditions to rebound post the soft first calendar quarter, accompanied by an upward bias in interest rates as the market absorbed continued Fed tapering. Directionally that economic assumption appears correct, though we were caught somewhat off guard by the revised 2.9% decline in first quarter GDP. The weak economic results, coupled with a surge in sovereign debt buying accompanied a meaningful reduction in U.S. Treasury bond rates. Furthermore, the turmoil in several Middle East countries lifted oil and gasoline prices, creating an overhang for consumer spending. That chain of events prompted high multiple stocks, primarily in the technology area, as well as market sensitive issues, to extend their first-quarter sell-off. Exiting the quarter, reports involving employment, bank lending, manufacturing, business confidence and transportation indicate that the economy is in fact rebounding.

Performance headwinds prevailed across most sectors of the portfolio during the second quarter. Thematically, an expectation for continued economic growth in the form of better corporate and consumer spending did not play out as expected. While somewhat puzzled by the recent relationship between economic data and the composition of market performance, our portfolio maintains a structure intended to benefit from continued domestic economic growth. Our rationale rests on an environment supported by a strengthening employment picture with job creation at post-recession highs, stable to improving manufacturing activity as reflected in the rising ISM number, and solid corporate profits and balance sheets. Thoughts on individual sector performance and positioning follow.

The consumer discretionary sector struggled and was the source of the largest relative under performance with specialty retail, particularly Dick's Sporting Goods, Tractor Supply, and Urban Outfitters, bearing the brunt of the negative return. While the first few months of the year were adversely impacted by weather, overall spending challenges persisted deeper into the quarter even as weather improved. Several industry groups within the consumer discretionary sector shook off the tough spending environment, including restaurant Buffalo Wild Wings and high-end retailer Tiffany. Both posted strong earnings results, and provided some offset to difficult performance from the retailers. Recent data on consumer confidence, as well as car and home sales indicate a better set-up for the second half. We expect that continued improvement in domestic employment, job growth has been

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running at a pace well over 200,000 per month, will also prove supportive of spending across retail categories. We made relatively few changes to the sector. We added to Buffalo Wild Wings and purchased a new position in HomeAway which provides travelers with access to a wide range of private accommodations through the internet. We expect strong growth given share gains versus traditional travel companies and the underlying strength in the travel industry.

The portfolio's technology holdings paced with sector returns during the quarter. Strength was most apparent in the semiconductor group, particularly Skyworks and Microchip, as both companies exhibited solid fundamental trends. Fortinet and Envestnet also performed well and offset weakness in other software industry holdings. Envestnet was a new addition during the quarter, replacing Teradata. The company offers a leading technology platform for financial advisors and we expect the quality of its base offering and the addition of incremental services will continue to attract new customers. Overall, we believe technology companies will experience a good second-half environment in 2014, as prospects are strengthening for both corporate and government spending.

It was an interesting quarter within healthcare as merger & acquisition activity heated up in part because the industry was active in the acquisition of foreign domiciled companies carrying lower tax rates. This sector has done some heavy performance work for us in the past year, but gave back some relative gains in the quarter. One source of underperformance stemmed from not owning Vertex as the biotech company received positive indications for a cystic fibrosis treatment in a late stage trial. Vertex posted a 31% return in June alone. We will tend to avoid significant binary events as a key investment driver, particularly when the existing business is unprofitable. Stock picking in select industries made a positive relative contribution. Of note, life science tool company, Illumina, continued to deliver strong earnings and a healthy backlog. We made several adjustments during the quarter. We sold Catamaran and Edwards Life Sciences out of concern over competitive trends and the impact on fundamentals. We also sold long-time holding Alexion. While the company provided the portfolio exposure to the biotech industry through a well-established and profitable business model, it moved out of the benchmark due to its large market cap size and we moved on as well. We reinvested sale proceeds by adding to Perrigo and introducing two new companies. We started a position in Envision Healthcare, a leading provider of healthcare services with a focus on physician staffing and ambulance emergency response services. We also bought Globus Medical, a device company focusing on the spine market which has attractive opportunities to grow through new product introductions and international expansion.

In the consumer staples sector, performance lagged in the quarter. As mentioned in our last letter, we've been out of sync in this sector as returns have kept pace or led the benchmark during the strong market advance. The second quarter delivered further merger activity within the sector, notably in the food and tobacco industries, but unfortunately not involving our holdings. We'll continue to assess our structure, but we expect staples companies to provide an element of stability with consistent earnings growth, but more modest revenue growth rates than other parts of the portfolio. During the quarter, we added a new position in Mead Johnson, a global company focused on pediatric nutrition. We remain modestly underweight the sector as slower growing sectors such as consumer staples and utilities tend to lag when the economy is advancing and we would expect that relationship to re-establish itself in the coming months.

Concerns over U.S. economic growth and an unexpected decline in long-term interest rates adversely impacted the portfolio's mix of financial stocks. Owning East West Bancorp and holding no REIT exposure proved challenging for near-term performance. In addition, merger & acquisition advisory firm Greenhill has not yet fully participated in the stepped up pace of deal activity. Long-time holding Alliance Data Systems traded down early in the quarter on what we believe was a misread of fundamental trends in their first quarter report. We added to the stock on the pullback as we believe the trends will strengthen for the company as the year progresses.

Portfolio holdings in the energy sector advanced in aggregate, but did not keep pace with what proved to be the benchmark's strongest performing sector. Energy stocks benefited from the rise in crude oil prices on the heels of increased geopolitical problems in the Middle East. Setting aside geopolitical concerns, we continue to like the backdrop for companies in this sector. Portfolio holdings remained relatively unchanged with only a modest trim to service provider, Oceaneering International. Significant investment spending in the energy segment continues to play out, positively affecting companies in the engineering and construction, petrochemical, and rail groups. The long-term benefits of lower levels of imported crude and cheap natural gas are likely to persist for the next decade or more. This area remains a very fertile area for new investment ideas outside the traditional holdings in exploration and production and oilfield services.

In the context of continued economic recovery, we believe the earnings expectations for industrial and materials businesses are reasonable. Even so, performance was a bit choppy during the quarter and portfolio holdings tried to keep pace as these areas, like other economically sensitive sectors, lagged more defensive companies. Business confidence, which shows signs of improving and should track economic growth, tends to spur higher levels of capital spending on plant and equipment – particularly important for many of our more traditional industrial businesses. A recent report we read indicated that the average age of U.S. manufacturing plants is over 15 years, 50% higher than much of the past 50 years. Coupled with strong balance sheets and low interest rates, companies are in good shape to invest in new or modernized capacity and we believe portfolio holding are positioned to benefit. As an example, the performance standout in the quarter was rail car manufacturer, Trinity Industries, which we added to the portfolio early this year. Trinity continues to benefit from increasing orders as crude by rail is driving incremental demand above and beyond the impact of growing economic activity. Potential changes in safety regulations also could provide a boost to demand. Outside of adding to Middleby after the stock pulled back, the only other change to this area was the sale of Roper Industries. After a strong run with the stock, we felt like recent acquisition activity was taking the company in a direction not contemplated in our original investment thesis.

Outlook

As we exit a second consecutive below trend line quarter for the economy, we believe the underpinnings for a reacceleration in activity are at hand. In our minds, economic positives outweigh the negatives and our portfolios reflect that bias. Our favorable outlook is supported by further gains in employment, improved capital spending, long term benefits from energy independence, and continued support from the Federal Reserve. Business confidence has also rebounded as of late, driving an increase in merger and acquisition activity.

With improvement in economic activity, as well as higher oil and some food prices, inflation did pick up modestly in the past quarter. This trend does bear watching as the Fed will need to be diligent as it relates to eventually raising interest rates. Appropriately timed tightening is no easy task, and the historical record is not great. Following a challenging quarter, we remain positioned for positive economic activity during the balance of 2014. With the discussed groundwork in place, we believe clients will be well served with our portfolio positioning. Our team dialogue remains focused on objectively assessing the investment landscape and diligently working our fundamental process. We thank you for your support of Baird Investment Management and our Mid Cap Growth strategy.

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 team members have equity ownership
- Deep sector expertise
- Average years of experience: 19 years

Investment Professional	Years of Experience	Years with Baird	Coverage Responsibility	Educational Background
Chuck Severson, CFA *Senior Portfolio Manager and Analyst*	27	27	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*	20	20	Financial Services Consumer Discretionary IT-Business Services	MS – Finance - The Applied Security Analysis Program BBA – Finance (UW – Madison)
Doug Guffy *Senior Research Analyst*	30	10	Energy & Industrials	MBA – Finance (Ball State University) BA – Economics & Government (Anderson University)
Jonathan Good *Senior Research Analyst*	14	8	Healthcare Information Technology	MBA – (Northwestern University – Kellogg) BS – Applied and Biomedical Sciences (Pennsylvania)
Chaitanya Yaramada, CFA *Senior Research Analyst*	5	5	Information Technology-Software	MBA (University of Chicago-Booth School of Business) BE – Bachelor of Engineering-Software (Univ. of Auckland, New Zealand)
Reik Read *Director of Baird Investment Management*	17	14	Director of Baird Investment Management	MBA – (UW – Madison) BS – Economics (UW – Madison)