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

Mid Cap Growth Equity
1st Quarter 2016

Market Update

An investor timing a three-month hiatus from all market-related news would likely assess the first quarter of 2016 as uneventful, considering relatively flat equity market returns. However, the path equity markets traveled proved anything but uneventful as investors endured volatile conditions during much of the quarter. A painful sell-off started the year, at least temporarily breaking the momentum-driven market of 2015, as recession fears caused many market segments to decline greater than 10%. As is typical for such a violent move, somewhat better economic data slowed the decline, in this instance by mid-February. When coupled with dovish commentary by global central bankers, U.S. equity markets rallied, led by cyclical issues. By quarter end most equity indices regained lost ground – quite a roller coaster ride to start the year.

Portfolio Commentary

Clients of the Baird Mid Cap growth portfolios kept pace with our primary benchmark, the Russell® Midcap Growth Index, outperforming in the downturn and trailing modestly in the recovery. Both our portfolios and the benchmark were relatively flat for the period. Solid performance in the consumer, healthcare and materials sectors offset more challenging results in the financial services and technology sectors, with producer durable and energy running relatively flat. We were fairly active making adjustments to the portfolio during the quarter. Market volatility provided ample opportunity to introduce new names and eliminate positions where conviction waned. In addition, the continued improvement in domestic employment data coupled with some signs of bottoming in industrial activity pushed us to move incremental capital toward more economically sensitive areas of the portfolio. Our sector thoughts and a more in depth description of portfolio changes follow.

The consumer discretionary sector led the way in relative performance as several areas contributed due to favorable stock picking. Specifically, Burlington Stores recovered from worries over the effect of warmer winter weather, which did not derail fundamentals as much as expected. Dollar General performed well on a better-than-expected earnings report and we believe the outlook remains quite positive. Hasbro, which was weak into year-end, recovered nicely as our thesis around the attractive sequence of licensed product revenue drivers (Star Wars, Disney Princess and Frozen) plays out. Regarding sector changes, we purchased a position in Domino's Pizza which replaced Buffalo Wild Wings. Domino's, despite its long history, in our view still has excellent opportunity for unit growth and is a leader in using digital technology to drive sales and efficiency. We sold the remaining position in Polaris with proceeds added to Lions Gate and WABCO. As noted in recent letters, we took a fair amount of weight out of the sector in recent quarters, particularly in specialty retail, and remain underweight. While we think the backdrop for consumer spending remains favorable due to continued job growth, signs of wage inflation and low energy costs, we are mindful of the meaningful duration of outperformance among key industries in the sector.

The materials sector delivered another solid quarter. Watsco, a distributor of HVAC equipment, advanced following a strong earnings report and outlook while Fastenal performed well, reacting to signs of bottoming in manufacturing activity and the mid-quarter jump in commodity prices. Acuity

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Brands appeared to take a breather and retreated with the market, providing an opportunity to add capital back to the position in anticipation that demand for its commercial lighting solutions remains solid.

The first quarter was not kind to many technology stocks and our mix didn't help matters as the sector lagged and holdings in the semiconductor industry declined rather sharply. Performance in this area stood in contrast to meaningful value added last year. The main culprit was Integrated Device Technology which declined after reporting a softer than expected quarter and more macro related headwinds than expected. The company has done a good job of product innovation over time and still has the Apple wireless charging opportunity ahead, which keeps us in the camp of staying with the position. Changes to the sector included the purchase of Monolithic Power Systems and Manhattan Associates, and the sale of Skyworks and Fortinet. Monolithic Power is a high quality semiconductor company that possesses one of the fastest top-line growth rates in the industry. The company has a host of new, higher-margin products that should expand its addressable market and drive higher profitability. Manhattan is a best-of-breed software provider focused on a supply chain and logistics for retailers. The portfolio remains in a slightly overweight position and despite the modest economic growth environment, we believe the sector offers plenty of good investment opportunities.

Energy sector performance was neutral during the quarter. Solid stock performance was mostly offset by the low portfolio exposure to the sector. We did make a position swap selling Concho Resources on the expectation that the company would not reach profitability in 2016. We purchased a position in Diamondback Energy, which has a strong property set that affords the company the ability to generate a profit even if oil prices remain low.

The portfolio's healthcare stocks won a war of attrition and the sector drove solid outperformance. This sector was the benchmark's worst performer as most notably, the biotech and specialty pharmaceuticals industries fell sharply. Our lack of exposure to these two industries proved quite helpful. As we have discussed in previous quarters, our focus on profitability has limited the opportunity set for us in these two areas. We did a fair amount of work on our structure in this sector, adding two new positions, Edwards Lifesciences and Intuitive Surgical and selling Envision Healthcare, Akorn, and Perrigo. Our belief is that these moves enhanced the growth outlook and fundamental strength within the sector. Edwards, a developer of products focused on treating structural heart disease, notably heart valves, looks to be on the front end of a strong new product cycle and with Intuitive, we have the opportunity to own an established growth company leading the way in producing robotic surgical systems. We also added to Acadia Healthcare, Cooper, and increased our initial moves into Edwards and Intuitive. The changes discussed above leave the portfolio slightly underweight the benchmark.

Holdings in the consumer staples sector outpaced benchmark performance. Our three largest positions, Constellation Brands, McCormick and Church & Dwight all continue to report solid fundamentals, managing through a sluggish global economy by using their product brand strength and good cost management to generate favorable growth. Our only concern, and this goes for much of the staples sector, is the sustained outperformance and resulting lift in valuations. As a result we've tended to trim into strength, holding the sector modestly underweight the benchmark. Where we had fundamental issues, we moved on, selling the positions in United Natural Foods and Mead Johnson. In an effort to remain balanced, we added a new position in Dr. Pepper Snapple. We believe the company is benefitting from improved pricing and mix rationalization across its core brands, and remains in in the early innings of a cost improvement program.

The producer durables sector gave back minor ground on a relative basis. The performance dynamic of the market, as earlier discussed, was very evident in this sector, as the sector shook off economic growth concerns and outperformed the growth index with strong gains realized in the last six weeks of the quarter. We shifted the sector's mix a bit during the quarter, attempting to take advantage of price weakness and some signs of bottoming in manufacturing activity. The result was a higher overall sector weight, now a bit overweight versus equal at year end, and a modest shift to more cyclicality. We purchased Graco, a leader in industrial fluid handling equipment, adding additional manufacturing exposure to the portfolio. We sold Wabtec (rail and transit part manufacturer) and reallocated capital from Stericycle (medical waste disposal) to A.O. Smith (manufacturer of water heaters), Rockwell (industrial automation) and Trimble Navigation (position-based technology for construction/agriculture).

Financial services lagged for the third straight quarter and produced the largest relative underperformance. Exposure to market-based revenue or credit proved a challenging starting point, with East West Bancorp, Alliance Data and Invesco falling the most. The volatile market environment pushed long interest rates lower, which again proved beneficial to REITs, an area where the portfolio held no exposure. Changes made to the sector included adding to Alliance Data Systems and Affiliated Managers with proceeds from the sale of Invesco. We also added to Euronet on what we viewed as unnecessary weakness following the report of quarterly results.

Outlook

As mentioned above, cyclical issues helped lift equities starting mid quarter - a distinct difference after a lengthy period of difficult performance due to slowing global growth, weak commodity end markets and the effects of a strong U.S. dollar. Recent data, specifically regional ISM manufacturing activity, indicates some improvement. Additionally, auto production remains strong, supported by employment and wage metrics. Finally, construction spending continues at solid levels.

Central bank policy certainly contributed to the significant sector rotation and cyclical stock rebound during the first quarter. Comments from bankers in Europe, Asia and the U.S. pointed to monetary policy that will remain accommodative for the foreseeable future. Domestically, Fed Chairman Yellen reinforced the notion that rate increases will likely be limited to two during 2016. Importantly, those comments resulted in at least a temporary decline in the dollar, further supporting the rally in export-driven cyclicals.

By no means does the rally ensure clear sailing for the rest of the year. Global economic growth is neither strong nor broad, and the true impact of massive global stimulus is difficult to quantify, likely making it hard to remove. First quarter earnings releases are delivered in the coming weeks and other risks will likely emerge. As for now, fundamentals are improving modestly, a most welcome sign. On behalf of everyone at Baird Equity Asset Management, we thank you for your support of our Mid Cap Growth strategy.

The Baird Equity Asset 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: 19 years

Investment Professional	Years of Experience	Years with Baird	Coverage Responsibility	Educational Background
Chuck Severson, CFA *Senior Portfolio Manager and Analyst*	29	29	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	22	Financial Services Consumer Discretionary IT-Business Services	MS – Finance - The Applied Security Analysis Program BBA – Finance (UW – Madison)
Doug Guffy *Senior Research Analyst*	32	12	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)
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