



Baird Equity
Asset Management

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

Small/Mid Value & Small Value 1st Quarter 2016

Many of the concerns we have written about regarding global growth and currency adjustments came home to roost as we began 2016. Equity markets around the world sold off hard as economic indicators reported domestic and overseas manufacturing contraction, credit spreads widened, the Chinese yuan fell, and oil prices plummeted yet again. Market expectations regarding the Fed swung from four federal fund rate increases this year to two or less. Markets put in lows by mid-February, however, and staged heroic rallies on the heels of a more dovish Federal Reserve and additional monetary easing overseas. For the quarter, most equity indices finished plus or minus a couple percent from flat for the year-to-date. The best performing asset class was gold.

Regarding our outlook, we foretold in last quarter's commentary:

“These negative 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.”

S&P 500 Change in Q116 EPS vs. Change in Price
(Source: FactSet)



Michelle E. Stevens, CFA
Portfolio Manager

Richard B. Roesch, CFA
Investment Analyst

Jonathan DeMoss, CFA,
CPA, CFP
Investment Analyst

Rob Zwiebel
Portfolio Specialist

Jesse Parsons
Trading & Operations Analyst

Indeed during the first quarter of 2016 we saw S&P 500 earnings expectations for the quarter revised lower by 9.6%, reflecting a -8.5% year-over-year earnings decline. The declines were broad-based, with 7 out of 10 sectors expected to experience falling profits, and all 10 sectors saw negative revisions for the quarter. If the index reports negative earnings growth for Q1, it will mark the first time it has seen four quarters of year-over-year declines since Q4 2008.

In terms of your Portfolio, our focus for the past three quarters has been to own companies with less downside earnings risk presented by these global problems. As we look at the Baird Small Value and Small/Mid Value Portfolios, we believe this effort has been successful and will earn superior returns in coming quarters. Please see the following chart, which highlights our portfolios' superior earnings expectations and revision trends.

	Q1 2016 EPS Growth	2016 EPS Growth (est)	Q1 2016 EPS Revisions	2016 EPS Revisions
Baird SMID Value	19.0%	13.7%	-3.3%	-1.4%
Russell 2500 Value	-0.6%	-1.6%	-7.2%	-6.6%
Russell 2500	-14.0%	2.9%	-12.3%	-6.3%
Baird Small Value	17.9%	12.8%	0.1%	-0.5%
Russell 2000 Value	1.9%	1.6%	-9.0%	-8.0%
Russell 2000	-20.7%	5.8%	-18.2%	-8.7%

Source: Factset

Baird Small/Mid Value Portfolio

The Baird Small/Mid Value Portfolio posted a return of 0.3% for the quarter versus a 3.3% return for the benchmark Russell 2500 Value. For the trailing 12 months, the Small/Mid Value Portfolio remains meaningfully ahead of the benchmark with a -3.8% return versus a -5.2% return for the Russell 2500 Value. The Portfolio outperformed significantly during the first half of the quarter but gave up that relative performance during the subsequent rally. Most of the best performing benchmark stocks off the bottom were previous underperformers and heavily shorted names.

Information Technology was primarily responsible for the portfolio lagging the benchmark, weighted down by weakness in J2 Global and Integrated Device

Technology. Despite a strong quarter, J2 was the victim of a short report and although IDTI missed earnings estimates, the company continues to offer compelling opportunities in wireless charging. The portfolio's underweight to Materials also detracted as the sector rebounded off its lows. Financials were the largest contributor to relative performance, led by strength in a number of real estate investment trusts (REITs) as interest rates declined during the period. Mid-America Apartments, Physicians Realty Trust and BioMed were among the winners. Our new positions in Utilities added value during the quarter, as well.

Portfolio trading during the quarter continued to focus on reducing exposure to companies with earnings risk related to a slowing economic environment. We exited Lithia Motors and Harman given signs that new car sales may be peaking for this cycle. We also sold Portfolio Recovery Group, Skyworks, Ryder and Targa Resources in anticipation of negative earnings revisions.

The proceeds from these sales were invested in both new positions and additions to existing holdings. Less economically sensitive sectors such as Utilities and Real Estate Investment Trusts absorbed the majority of the proceeds. New positions include Alliant Energy, Pinnacle West, Physicians Realty Trust, Healthcare Trust of America and Agree Realty.

Baird Small Value Portfolio

The Baird Small Value Portfolio posted a return of 1.1% for the quarter versus a 1.7% return for the benchmark Russell 2000 Value. For the trailing 12 months, the Small Value Portfolio significantly outperformed the benchmark returning -4.7% versus a -7.7% return for the Russell 2000 Value. The Portfolio outperformed significantly during the first half of the quarter but gave up that relative performance during the subsequent rally. Most of the best performing benchmark stocks off the bottom were previous underperformers and heavily shorted names.

Information Technology was primarily responsible for the portfolio lagging the benchmark, weighted down by weakness in J2 Global and Integrated Device Technology. Despite a strong quarter, J2 was the victim of a short report and although IDTI missed earnings estimates, the company continues to offer compelling opportunities in wireless charging. The portfolio's underweight to Materials also detracted as the sector rebounded off its lows. All other economic sectors were positive contributors. Financials were the largest contributor to relative performance, led by strength in a number of real estate investment trusts (REITs) as interest rates declined during the period. Mid-America Apartments, Physicians Realty Trust and BioMed were among the winners. Our new positions in Utilities added value during the quarter, as well.

Portfolio trading during the quarter continued to focus on reducing exposure to companies with earnings risk related to a slowing economic environment. We sold Lithia Motors given signs that new car sales may be peaking for this cycle. We also sold Portfolio Recovery Group and Encore Capital on the heels of weakening credit conditions, as well as Skyworks, Ryder and Targa Resources in anticipation of negative earnings revisions.

The proceeds from these sales were invested in both new positions and additions to existing holdings. Less economically sensitive sectors such as Utilities and Real Estate Investment Trusts absorbed the majority of the proceeds. New positions include Alliant Energy, Connecticut Water, Physicians Realty Trust, Healthcare Trust of America, Agree Realty and Meta Financial Group.

Thank you for your continued support and partnership.

Michelle E. Stevens, CFA

Portfolio Manager

The Baird Equity Asset 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.

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.

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