

V FOR VOLATILITY

Volatility returned with a vengeance...virtually evaporating vaults of value investors had ventured against the VIX and vexing voyeurs not envisioning vicissitude.

V stands for Victory for active small and mid cap equity managers. During periods of high volatility, small cap value managers have produced alpha of 1.4 versus periods of low volatility when they have produced alpha of -0.7¹. The low volatility environment of the past few years has been accompanied by strong asset flows to passive strategies. Indeed, a rising tide lifts all boats and since index strategies buy everything in the index indiscriminately, strong ETF flows create an environment that makes it more difficult for active managers to beat their benchmark. However, passive strategies can't have their cake and eat it too. When money flows out of ETFs, active managers win. So too, high quality stocks as measured by return on equity perform better by a monthly spread of 230 basis points¹ when money flows out of ETFs, not in. Good portfolio managers don't need volatility to produce superior returns over time, but a little tailwind never hurts.



BAIRD SMALL/MID VALUE PORTFOLIO

For the quarter, the Baird Small/Mid Value Portfolio outperformed its benchmark, delivering a total return of -1.8% versus -2.7% for the Russell 2500 Value. For the last twelve months, the portfolio returned 17.2%, outpacing the benchmark return of 5.7%. Further, the portfolio has outperformed the Russell 2500 Value over nearly every trailing time period and delivered an average annual return since inception of 12.0% (January-2000) versus 10.0% for the benchmark.

The Portfolio benefited from sector allocation changes made during 2017. Only three sectors within the Russell 2500 Value produced positive returns in the first quarter: Information Technology, Healthcare and Financials. These three sectors represent 55% of the SMID portfolio versus 38.2% in the benchmark. The portfolio's largest overweight position is currently Information Technology which was among the best performing sectors in the benchmark for the period. Furthermore, strong security selection within our holdings added to performance with top contributors including Cypress Semiconductor,

SMALL & SMALL/MID VALUE EQUITY INVESTMENT TEAM

MICHELLE STEVENS, CFA
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Senior Research Analyst

ROB ZWIEBEL
Portfolio Specialist & Consultant Relations

JESSE PARSONS
Trading & Operations Analyst

PHILOSOPHY & PROCESS

- The portfolio is grounded in the belief that value and growth investing are not mutually exclusive.
- Emphasis on companies likely to exceed "street" expectations but trade at a discount to our in-house calculation of fair value.

PORTFOLIO CONSTRUCTION

- Concentrated portfolio of 40-50 stocks
- Top holdings generally limited to 5% at cost, 8% at market
- Sectors capped at 30% excluding financials
- Buy and hold approach

Stamps.com and J2 Global. The portfolio is also overweight healthcare and ICU Medical helped fuel outperformance for the period on the heels of good earnings. Within Financials, Bofi Holdings and Meta Financial Group soared to new highs posting gains of 35% and 18%, respectively. Boingo Wireless also posted solid gains compounding its solid performance over the past two years.

Two individual holdings meaningfully underperformed during the quarter. Atlas Financial Group, which provides commercial auto insurance, surprised investors by posting a large loss as a result of reserve strengthening related to prior accident years. Management credibility has been severely impaired as they had previously assured us that loss-related issues were confined to Michigan and had been adequately reserved. Our best performing stock for 2017, Zagg Inc., also saw its stock decline in the quarter on a small negative earnings guidance revision as they transition sales from a distributor to direct to their largest customers. This change will lower revenue temporarily as the distributor destocks but should boost margins over the long run. Fortunately, we had trimmed the position twice last year, which helped mitigate the impact. Other notable stocks that held back gains were Solaris and Orchids Group.

During the quarter, we initiated positions in two new holdings: Essent Group and Ryman Hospitality Properties. We also added to Atlas Air, Dolby and Davita. We took profits in Skyworks and Healthcare Trust of America to fund the new purchases, as well as trimming other long-time winners Hexcel, LabCorp and Lamb Weston.

BAIRD SMALL CAP VALUE PORTFOLIO

The Baird Small Cap Value Portfolio performed generally in line with its benchmark for quarter delivering a total return of -2.9% versus -2.7% for the Russell 2000 Value. For the last twelve months, the portfolio returned 15.0% outpacing the benchmark return of 5.1%. Further, the portfolio has outperformed the Russell 2000 Value over the trailing 3-yr and 5-yr periods and delivered a since inception (March 2005), average annual return of 9.6% versus 7.4% for the benchmark.

The Portfolio benefited from sector allocation changes made during 2017. Only two sectors within the Russell 2000 Value produced positive returns in the first quarter: Healthcare and Financials. The portfolio's largest overweight position is currently Information Technology, which also posted a positive return for the quarter despite the benchmark posting a negative return. Strong security selection within our holdings added to performance with top contributors including Cypress Semiconductor, Immersion and Stamps.com. The portfolio is also overweight healthcare and ICU Medical helped fuel outperformance for the period on the heels of good earnings. Within Financials, Bofi Holdings and Meta Financial Group soared to new highs posting gains of 35% and 18%, respectively. Boingo Wireless also posted solid gains compounding its solid performance over the past two years.

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During the quarter, we initiated a new position in Immersion Corp. as well as added to Atlas Air. We took profits in Capitol Federal Financial and Healthcare Trust of America to fund the purchases, as well as trimmed long-time winner Patrick Industries.

If you are interested in more detail on 2017 performance or our outlook for 2018, please request the recording for the Baird Equity Asset Management Small Value and Small/Mid Value conference call held on Thursday, April 12, 2018.

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

¹Source: Jefferies U.S. Equity Strategy SMID-Cap Manager Scorecard April 1, 2018

Top 5 Small/Mid Value Portfolio Contributors			Bottom 5 Small/Mid Value Portfolio Contributors		
Security	Avg. Weight	Contribution	Security	Avg. Weight	Contribution
BOFI HOLDING	3.23%	0.91%	AIR TRANSPORT SERVICES	2.63%	0.02%
META FINANCIAL GROUP	4.81%	0.70%	LEIDOS HOLDINGS	2.06%	0.03%
ICU MEDICAL	3.71%	0.58%	SKYWORKS SOLUTIONS	0.55%	0.04%
BOINGO WIRELESS	5.99%	0.51%	DOLBY LABORATORIES	2.12%	0.05%
CYPRESS SEMICONDUCTOR	3.12%	0.31%	INTEGRATED DEVICE TECHNOLOGY	2.06%	0.05%

Top 5 Small Cap Value Portfolio Contributors			Bottom 5 Small Cap Value Portfolio Contributors		
Security	Avg. Weight	Contribution	Security	Avg. Weight	Contribution
BOFI HOLDING	3.20%	0.90%	AIR TRANSPORT SERVICES	2.63%	0.02%
ICU MEDICAL	4.86%	0.75%	CAPSTEAD MORTGAGE	2.01%	0.05%
META FINANCIAL GROUP	4.71%	0.68%	INTEGRATED DEVICE TECHNOLOGY	2.05%	0.05%
BOINGO WIRELESS	6.05%	0.51%	ATLAS AIR WORLDWIDE	1.93%	0.06%
CYPRESS SEMICONDUCTOR	3.18%	0.31%	HEXCEL CORP	2.35%	0.09%

The Baird Equity Asset Management Small & Small/Mid Value Equity commentary is incomplete if not accompanied with the most recent performance report. Performance for the Small & Small/Mid Value Strategies can be found on our website BairdEquityAssetManagement.com, or by clicking on the following links: [Small Cap Value Strategy](#) & [Small/Mid Cap Value Strategy](#).

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. Indices are unmanaged and direct investment is not possible. Past performance is no guarantee of future results.

As of 03/31/18, the top ten holdings for the Baird Small/MidCap Value Strategy were: Boingo Wireless 6.2%; Meta Financial Group 5.0%; ICU Medical 4.1%; Bofi Holdings 3.7%; American Financial Group 3.5%; Stamps.com 3.4%; Cypress Semiconductor 3.2%; Silicon Motion Technology 2.8%; NMI Holdings 2.6%; and Air Transport Services 2.6%.

As of 03/31/18, the top ten holdings for the Baird Small Cap Value Strategy were: Boingo Wireless 6.3%; ICU Medical 5.4%; Meta Financial Group 5.0%; Bofi Holdings 3.7%; Stamps.com 3.4%; NMI Holdings 3.3%; Cypress Semiconductor 3.2%; j2 Global 3.0%; Lamb Weston 2.9%; and Algonquin Power & Utilities 2.9%. The performance of any single portfolio holding is no indication of the performance of other portfolio holdings of the Baird Small Cap Value Strategy or Baird Small/Mid Cap Value Strategy.

Investment Professional	Years of Experience	Years with Baird	Educational Background
Michelle Stevens, CFA Senior Portfolio Manager	25	6	MBA – (University of Cincinnati) BS – Economics (Wittenberg University)
Richard Roesch, CFA Senior Research Analyst	25	6	BS – Finance (Butler University)
Jonathan DeMoss, CFA, CPA, CFP Senior Research Analyst	22	6	MBA – (Indiana University) BS – Accounting & Management (Iowa State University)
Rob Zwiebel Portfolio Specialist & Consultant Relations	27	6	BS – Finance (University of Dayton)
Jesse Parsons Trading & Operations Analyst	13	6	BBA – Finance & Marketing (University of Kentucky)