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

Mid Cap Growth Equity
4th Quarter 2016

Market Update

Uncertainty surrounding the presidential election, a relatively lackluster earnings reporting cycle and questions about a rate hike from the Federal Reserve paved the way for stocks to sell off in October, only to rally significantly in November. The rally was likely due to the confluence of the election's conclusion, a boost in investor optimism, and better domestic and international economic data. Stocks flat-lined into the finish during December resulting in a modest quarterly gain.

Portfolio Commentary

Clients of the Baird Mid Cap Growth portfolios experienced a modest increase during the fourth quarter, in line with our primary benchmark, the Russell® Midcap Growth Index. Within the portfolio, sector results included positive contributions from financials, consumer discretionary, energy, and producer durables, while the information technology, materials, healthcare, and consumer staples sectors lagged. Our sector thoughts and a more in depth description of portfolio changes follow.

The financial services sector, for the second straight quarter, drove the portfolio's largest relative outperformance. Returns were led by the two bank holdings, East West Bancorp and First Republic, which experienced a significant post-election bump as interest rates moved higher across the yield curve with the Fed tightening in December for the first time in a year and the 10-year treasury rate rising from 1.6% to 2.5%. These moves negatively impacted REITS, an area where we held no exposure. Our bank holdings have been in place for some time because we believe the management teams can compound returns by growing earnings at attractive rates relative to their valuation levels. We think there is more room to go for these companies, but also acknowledge the risk of a price pullback given the magnitude of the move up in such a short period of time. During the quarter, we added two new names, MarketAxess and Broadridge Financial, while trimming Fiserv and Affiliated Managers. MarketAxess offers a leading electronic platform for bond trading. We expect increased penetration of electronic trading, with MarketAxess growing faster than the market and expanding revenue streams as its platform strengthens. Broadridge serves key roles behind the scenes in the financial services industry, operating as the leading provider of proxy voting services as well as trade clearing and processing. We expect management to deliver an attractive return profile by building on strong market positions and a high level of recurring revenues augmented with disciplined capital management. Our positioning as we begin 2017 suggests we are underweight the sector, however, we note that when excluding REITs we are overweight what we view as traditional financial services companies.

The consumer discretionary sector provided an assist to relative performance with Harman delivering a key lift on its announced sale to Samsung. In addition, lululemon reacted favorably to its quarterly earnings report and outpaced weakness in other apparel names. Positive performance from retailers, Dollar General and Ollie's Bargain Outlet, as well as cable provider, Cable One, also helped. The fits and starts of the consumer in recent years, even with employment and wages improving, have created a fair amount of volatility in the sector. We continue to look for areas with favorable spending profiles, working to maintain a good diversity of end market exposure and using price volatility to our advantage. As far as changes in the quarter, we purchased Ulta Salon Cosmetics & Fragrance, Pool Corporation, and Panera Bread Co. Ulta is a profitable beauty retailer gaining share in the fragmented beauty

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category. We believe the company is poised to outgrow its peers and nearly all retailers over the next few years. We initiated Pool Corporation to further diversify our housing exposure (and trimmed Fortune Brands as a balance). Pool is a market leader in the niche pool distributor industry that is seeing strong growth as the housing market further normalizes and consumers spend on deferred projects. Panera operates and franchises fast casual bakery-café restaurants. We believe the company's investments and leadership positioning in non-traditional restaurant sales (delivery, ready-for-pick-up, and catering) should allow it to enjoy industry-leading sales and earnings growth in the years ahead. We sold our position in Tractor Supply on slowing business fundamentals and concern over the announced acquisition of a pet store retailer. Elsewhere, we trimmed Domino's to make room for Panera, trimmed LKQ on strength, and added to Ollie's Bargain Outlet to fill the position. We also sold Harman due to its announced sale, and allocated the proceeds to our other auto software holding, Mobileye.

The consumer staples sector provided a modest performance headwind in the quarter. Weakness in two long-time holdings, McCormick and Church & Dwight, caused the shortfall. There appears to have been some unwind in the attractiveness of staples, not surprising with rates moving higher and leading to capital exiting a sector that provided yield and a reasonable measure of earnings stability in a low-rate, low-growth world.

For the healthcare sector, uncertainty ruled the day as odds of a repeal of the Affordable Care Act are higher post-election with no firm knowledge of what the replacement solution will look like. This heightened level of risk caused a negative reaction across the sector with notable weakness in service-related industries, which impacted Acadia Healthcare and LabCorp. Results that did not meet high expectations for Edwards Lifesciences also hurt relative performance, and Intuitive Surgical declined more than the benchmark. As far as changes, we added to Acadia Healthcare on weakness and trimmed LabCorp and IDEXX Laboratories to manage the overall sector weight lower. We are currently comfortable operating underweight the benchmark in this sector given the increased uncertainty as it relates to changes in healthcare policy. Volatility within healthcare is likely and it may well lead to performance blips and create buying opportunities as well.

With a substantial improvement in oil prices during the year, strong performance from Diamondback Energy helped the energy sector provide solid, positive relative performance–this despite its absolute small weight in the benchmark. We added modestly to our Diamondback holding, and the portfolio has a small absolute overweight moving into the New Year.

The materials sector served as a drag on relative performance. Acuity Brands, a commercial lighting solutions provider, pulled back on concern over near-term demand activity, dragging down sector returns. The weakness in Acuity, which has added value over several years, overshadowed a strong advance by Fastenal, which we are optimistic will react to even a modest uptick in domestic manufacturing activity. We added to the position during the quarter.

The producer durables sector made a modest positive contribution to relative performance. The portfolio's overweight position proved beneficial as the sector provided the strongest absolute returns in the benchmark for the quarter. The pick-up in manufacturing related data, most notably the PMI, helped lift the more cyclical companies in the sector. We initiated a position in Oshkosh Corporation, a manufacturer of specialty commercial and military trucks. Oshkosh's access equipment segment, which represents about half of the revenue line, is poised to benefit from increased government infrastructure spending. We anticipate some form of new fiscal stimulus following the presidential election, and believe Trump's victory increases the odds of action beneficial to Oshkosh. We started a position in Verisk Analytics, a strong company operating in the insurance information/analytics business. Their business is fairly sticky, with a majority of revenues coming from long-term contracts and subscriptions. We sold Genpact to reduce some of our defensive weight in durables and moved the capital into Oshkosh and Fastenal.

The technology sector continued its second-half struggle during the quarter and was the source of the portfolio's largest underperformance. Returns from semiconductor holding Monolithic Power fell well short of the very strong move in this industry led by NVIDIA, which rose sharply and was not held in the portfolio. Other areas of technology, including the software and services industry, generally pulled back in price, likely due to investor rotation toward more cyclical areas of the market as well as some compression in higher multiple stocks as interest rates advanced. Our moves in the sector were fairly limited and included the sale of Manhattan Associates on concern over its slowing retail end-markets, and small adds to Tyler Technologies and Ultimate Software. The portfolio enters 2017 in-line with the benchmark, which we view as a good starting point as we weigh generally attractive company fundamentals in the sector against the potential for the trends previously mentioned, leading to opportunities in other areas of the market.

Outlook

Economic activity showed improvement during the second half of 2016 and stocks took the news well. The inflection in growth was broad based, with China, the U.S. and Europe leading the expansion. After so many years of monetary stimulus and no real improvement, it's hard to believe that this economic lift will have legs, but the world exited 2016 in better economic condition than it started. Additionally, consumer and business confidence rose significantly following the presidential election, finishing at multi-year highs.

As we look back on not only the fourth quarter, but all of 2016, volatility was constant. Starting with recession fears, a meaningful market correction and snap-back rotation in the first quarter, to the brief, but unsettling Brexit panic mid-year, to the November election, market moves were quick and severe. Our portfolio positioning rested on the economy and earnings pacing at low single digit growth, the likelihood of modest Fed tightening and balanced sector weights. Cyclical exposure was added during the first half of the year and remained in place through the election, proving helpful.

The presidential election merits discussion as we flip the calendar to 2017. Prospects for lower tax rates, repatriation of foreign profits and cash, and a rollback of regulations are reasons for optimism and have impacted investor sentiment and business and consumer confidence measures in a positive way. However, we believe none of the legislative agenda items will come easy and the sequencing of priorities is very important, but still unknown. The President-elect also inherits an economy that is at or near full employment, a stronger dollar and a Federal Reserve that has indicated it will raise rates three times in 2017, all making the path toward faster economic growth more challenging. Our strategy, not surprisingly, is to work to assemble a portfolio of businesses with the management teams and balance sheets ready to take advantage of opportunities.

On behalf of Baird Equity Asset Management and our Mid Cap Growth team, thank you for your support and we wish all of you a very Happy New Year.

Top 5 Portfolio Contributors			Bottom 5 Portfolio Contributors		
Security	**Avg. Weight**	**Contribution**	**Security**	**Avg. Weight**	**Contribution**
East West Bancorp (EWBC)	2.02	0.66	LKQ Corporation (LKQ)	2.25	-0.32
Akamai Technologies (AKAM)	1.64	0.37	Intuitive Surgical (ISRG)	2.26	-0.32
Harman International (HAR)	0.68	0.34	Tyler Technologies (TYL)	1.81	-0.35
CDW Corp (CDW)	2.17	0.30	Acadia Healthcare (ACHC)	1.26	-0.46
JB Hunt Transport (JBHT)	1.47	0.28	Edwards Lifesciences (EW)	2.10	-0.63

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*	30	30	Industrials & Materials	MS – Finance - The Applied Security Analysis Program BBA – Accounting and Finance (UW – Madison)
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