

Small/Mid Value & Small Value 4th Quarter 2016

Euchred

As a Midwesterner, I grew up on the popular German card game, euchre. For those not familiar with the game, the object is to win at least three of the five rounds or tricks played. Advantage typically goes to the player who holds the highest cards of the suit named trump (which can win a trick where a card of a different suit has been led). How is this relevant to our performance in the second half of 2016? In short, we didn't hold enough Trump cards.

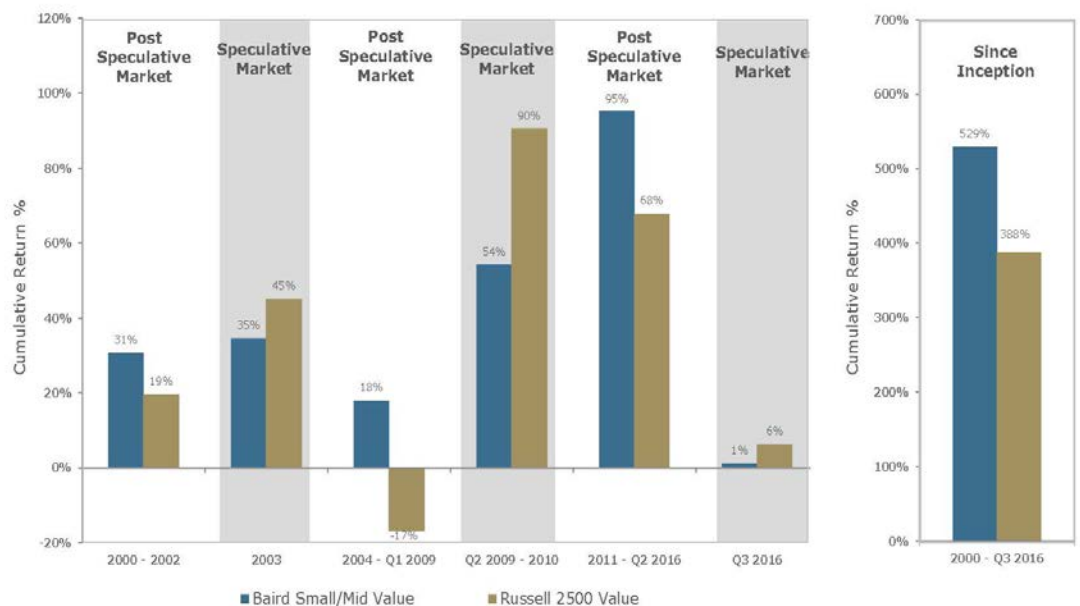
Although during the past couple years we have witnessed the market rotate for short-time periods to "risk on" or "low quality", those gains have quickly reversed as hopes for economic/earnings reacceleration did not materialize. Market leadership instead, had been dominated by companies offering earnings growth, stability and attractive capital structures.

The surprise Trump victory coupled with a Republican-controlled Congress derailed that trend. Post-election, the Russell 2000 Value rallied 17.4%, the best November in the history of the benchmark and the largest margin of victory for small caps over large caps, with the S&P 500 up 5.0% over the same period. Like many managers, we were caught by surprise in terms of both the election and the market's bullish reaction. In fact, only 10% of small cap value managers were able to best the benchmark in 2016.

Over the past 17 years, we have experienced only three other similar speculative markets when low quality stocks outperformed by such a wide margin in a short period of time. Although we posted solid positive returns in these environments, we have also tended to trail the benchmark meaningfully due to our higher quality bias. Post these short-lived, intense periods of speculation, we have historically outperformed for multi-year periods and also on a cumulative basis.

Discipline Through Market Cycles

High Quality Outperforms Over the Long-Term



Peer Ranking %	30 th	78 th	1 st	99 th	11 th	99 th
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Source: PSN 12/2016 - Monthly

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Leading the post-election charge were sectors heretofore unloved, but now expected to benefit asymmetrically from the new political environment. Materials, Industrials and Energy stocks clocked multi-year gains in a matter of weeks...many companies in these sectors posting triple-digit returns. Small regional banks, the largest industry in our benchmark, levitated despite a low growth profile for the group.

Such swift moves in such a brief time period are indicative of speculation versus fundamental investing. As such, we feel it is prudent to stay disciplined to our investment style which has outperformed over the long-run with lower commensurate risk. Our outperformance in December is encouraging that the rotation in favor of quality has perhaps already begun.

We concur with consensus that the prospects for tax reform, fiscal stimulus, and relaxed regulation under the new Administration should serve to benefit corporate earnings over the coming years. However, what policies become realities, which companies stand to benefit and by what magnitude, is to say the least, difficult to handicap at this stage. In addition, the potential negative ramifications outside our borders of changes to our trade policy and a stronger currency must be considered, as well.

Consistent with our disciplined investment style, we continue to analyze each investment prospect on its merits. To the extent we can make high conviction assumptions based upon a Trump presidency, we will incorporate those in our earnings models; always with an eye on what we pay for those earnings.

Baird Small/Mid Value Portfolio

The Baird Small/Mid Value Portfolio delivered a total return of 4.1% for the quarter, trailing the 9.3% return of the benchmark Russell 2500 Value.

Performance during the three months was negatively impacted by lower than benchmark returns for our holdings in Consumer Discretionary, Real Estate Investment Trusts and Utilities. In Discretionary, Zagg was weak on indigestion from its recent Mophie acquisition which we expect to be short-lived as they work through supplier issues and sales remain robust. Utilities and REITs pulled back as interest rates rose and offered some renewed competition for yield investors. Silicon Motion, despite a beat and raise earnings report, declined 17% for the quarter. B&G Foods was also a notable detractor on a slight earnings miss for the quarter although guidance for the year was maintained.

In terms of positives; our Financial, Healthcare and Telecommunication holdings outperformed for the quarter. Banks in the Russell 2500 Value popped 30% in the quarter and we had a number of large movers in the portfolio including BofI Holdings and Meta Financial which were standouts in terms of positive performance. New holdings, Boingo Wireless and Stamps.com, were among the best performers for the period.

During the quarter, we allocated money to several new securities with attractive growth prospects. In the Industrial sector we initiated positions in Orbital ATK, Air Transport Services Group and we revisited Quanta Services, a former holding. In Financials we added Hilltop Holdings and Diamond Hill Investment Group. We purchased Cypress Semiconductor and sold Integrated Device in the Technology sector. Other sales included Pinnacle Foods, Omega Healthcare, H&R Block and Aceto.

Baird Small Value Portfolio

The Baird Small Value Portfolio delivered a total return of 6.7% for the quarter trailing the 14.1% return of the benchmark Russell 2000 Value.

Performance during the three months was negatively impacted by lower than benchmark returns for our holdings in Real Estate Investment Trusts, Consumer Staples, Consumer Discretionary and Information Technology. In Discretionary, Zagg was weak on indigestion from its recent Mophie acquisition which we expect to be short-lived as they work through supplier issues and sales remain robust. REITs pulled back as interest rates rose and offered some renewed competition for yield investors. B&G Foods was also a notable detractor on a slight earnings miss for the quarter although guidance for the year was maintained. Silicon Motion, despite a beat and raise earnings report, declined 17% for the quarter.

In terms of positives; our Healthcare, Industrial and Telecommunication holdings outperformed for the quarter. Banks in the Russell 2000 Value popped 30% in the quarter and we had a number of large movers in the portfolio including Bofi Holdings and Meta Financial which were standouts in terms of positive performance. New holdings, Boingo Wireless and Stamps.com, were also among the best performers for the period.

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Thank you for your continued support and partnership. We will be hosting our quarterly conference call with additional insights on January 19 at 2:00 ET. Please contact us if you would like additional details on the portfolio or call.

Michelle E. Stevens, CFA

Portfolio Manager

Baird Small/Mid Cap Value					
Top 5 Portfolio Contributors			Bottom 5 Portfolio Contributors		
Security	Avg. Weight	Contribution	Security	Avg. Weight	Contribution
Meta Financial Group (CASH)	4.82	2.60	LTC Properties (LTC)	3.48	-0.38
Renasant Corp. (RNST)	2.97	0.79	Physicians Realty Trust (DOC)	3.10	-0.44
Boingo Wireless (WIFI)	3.50	0.69	B&G Foods (BGS)	3.58	-0.45
j2 Global (JCOM)	2.85	0.64	Omega Healthcare Investors (OHI)	1.62	-0.59
American Financial Group (AFG)	3.09	0.58	Silicon Motion Technology (SIMO)	3.31	-0.69

Baird SmallCap Value					
Top 5 Portfolio Contributors			Bottom 5 Portfolio Contributors		
Security	Avg. Weight	Contribution	Security	Avg. Weight	Contribution
Meta Financial Group (CASH)	4.63	2.55	LTC Properties (LTC)	3.51	-0.41
Renasant Corp. (RNST)	2.97	0.76	Physicians Realty Trust (DOC)	2.96	-0.44
BofI Holding (BOFI)	2.64	0.71	B&G Foods (BGS)	3.47	-0.47
Boingo Wireless (WIFI)	3.47	0.70	Zagg (ZAGG)	2.91	-0.48
j2 Global (JCOM)	3.00	0.68	Silicon Motion Technology (SIMO)	3.19	-0.68

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.

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The S&P 500 Index is a representative sample of 500 leading companies in leading large-cap industries of the U.S. economy.

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

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