Important Information about Non-Rated, Split-Rated, and Below Investment Grade Securities

Baird has prepared this document to help you understand the characteristics and risks associated with an investment in non-rated or low rated securities, also known as "below investment grade" securities, so that you can make an informed decision when buying or selling these securities. Non-rated and below investment grade securities are not suitable for all clients. Your Baird Financial Advisor can further explain the features, characteristics and risks of any particular security under consideration for your account.

Characteristics of Below Investment Grade Securities

Below investment grade securities are securities that are not rated in one of the four highest rating categories of a nationally recognized rating agency such as Moody's or S&P. Specifically, securities rated lower than Baa3 by Moody's or BBB- by S&P are below investment grade. Securities rated below Baa3 are described by Moody's as speculative and, at a minimum, subject to substantial credit risk. Securities rated below BBB- are described by S&P as having significant speculative characteristics and while their issuers may have some positive characteristics, they may be outweighed by large uncertainties or major exposures to adverse conditions. Non-rated securities present additional uncertainty because of the difficulties in determining their comparability to rated securities. Non-rated securities are often comparable to below investment grade securities. Small issues of municipal securities may also be non-rated.

As detailed below, below investment grade securities typically offer a higher yield, but generally carry more risks than higher rated securities with similar maturities. As a result, an investment in below investment grade securities is considered speculative.

Below investment grade securities typically fall into one of the two following categories:

- **Below investment grade bonds.** Below investment grade bonds contain the same technical characteristics as other bonds, but differ based on the relatively lower credit quality of their issuers. As a result, these bonds, sometimes referred to as "junk" bonds, carry a higher risk of a loss of principal than higher rated bonds. These bonds typically pay a higher yield than other bonds, reflecting the issuer's inability to borrow inexpensively relative to other issuers with a higher credit quality.

- **Below investment grade preferred stocks.** Although the characteristics of preferred stock vary depending on the specific issuer, preferred stock typically has characteristics of both debt and equity. Holders of preferred stock are typically entitled to receive both a fixed dividend payment and to participate in any appreciation. While this combination may be attractive to some investors, an investment in below investment grade preferred stocks may carry a greater risk of loss relative to an investment in a bond in the event of an issuer's bankruptcy. This is because holders of preferred stock are paid only after all debt holders in a bankruptcy proceeding.

Because of the complexity associated with evaluating the quality of non-rated and below investment grade securities and their issuers, the market for below investment grade securities is dominated by institutional investors. Individual investors who wish to invest in non-rated or below investment grade securities may consider investing in a fund whose purpose is to invest in such securities, allowing the investor to take advantage of professional management and diversification of investments across different assets.

Understanding the risks

The risks associated with purchasing a non-rated, split-rated, or below investment grade security are important considerations in making a purchase decision. As noted above, non-rated, split-rated, and below investment grade securities generally carry more risk than investment grade securities. Such risks include, but are not limited to:

- **Price volatility risk.** A non-rated, split-rated, or below investment grade security's market value and yields may be affected significantly by changes or developments that pertain to the issuer and its industry. Market values and yields on securities rated below investment grade may tend to be correlated with equity returns, particularly the returns on small cap stocks. In addition, these securities, like all fixed income securities, will be affected by changes in prevailing interest rates. Generally, when interest rates rise, the security's market value declines and when interest rates fall, the security's market value increases. However, securities rated below investment grade tend to be less sensitive to interest rate fluctuations than investment grade securities because their coupon or interest rates are generally high.

- **Credit, default and bankruptcy risk.** Issuers of securities receiving the lowest investment ratings, compared to other higher grade securities, may have a weakened capacity to make required principal and interest payments. This may be due to overleveraging, potential cash flow challenges or other factors. Issuers of below investment grade securities are more susceptible to default and bankruptcy during a period of prolonged deterioration in economic conditions or other adverse circumstances. Investments in non-rated securities also carry the risk of default associated with the issuer, which may impact the safety of the client's invested principal

- **Liquidity risk.** Non-rated, split-rated, and below investment grade securities may be difficult or impossible to sell at a desired time and price which may cause an owner to have to lower the price, sell other securities or forego an investment opportunity. Many bonds and unconventional products trade infrequently or irregularly unlike exchange traded equities, and clients should be made aware that their sales may not always be executed immediately or that sales may occur at prices well below a client's purchase price or anticipated market price. Any of these results may have a negative effect on the performance of a client's account.

- **Ratings and informational risk.** In some cases, securities may have split ratings, with the ratings agencies assigning different ratings to the same security. In addition, ratings changes may not be made on a timely basis. There may also be limited information available about or from issuers of non-rated or below investment grade securities.

Before investing in non-rated, split-rated, or below investment grade securities, it is important to understand and discuss with your Baird Financial Advisor the structure and terms of the security and the potential risks. Investors in non-rated, split-rated, and below investment grade securities should have a high tolerance for risk, including the willingness and ability to accept significant price volatility, potential lack of liquidity and potential loss of their investment. If buying such securities in an offering, you should obtain and read the prospectus. If buying such securities in the secondary market, you should review the issuer's publicly available financial and other information (such as recent annual, quarterly and current reports). You can obtain these materials from your Baird Financial Advisor or on the SEC's EDGAR database at www.sec.gov.