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A Focus On Essentials

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UNDISCOVERED MANAGER

Laura Lallos is the managing editor of *Morningstar* magazine.

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In every issue, Undiscovered Manager profiles a noteworthy strategy that hasn't yet been rated by Morningstar Research Services' manager research group.

Chautauqua Capital Management's roots go deeper than its 2009 founding.

When Brian Beitner started the firm, it was "inauspicious timing, but a unique opportunity." He'd already launched his own international- and global-stock strategies several years earlier at former employer TCW Group, where he'd partnered with noted growth investor Glen Bickerstaff, who'd come over from Transamerica Investment Management. Amid the upheaval of the financial crisis, TCW allowed Beitner to take the strategies' records and set up shop on his own. "I knew getting new business would be slow in that environment," Beitner remembers,"but I needed time to attend to such matters as registering with the SEC anyway."

Beitner had been commuting from Boulder, Colo., to TCW's Los Angeles headquarters and was happy to remain in place with his new boutique. The location, he says, is an advantage for a young investment management firm, as Boulder's quality of life attracts applicants to Chautauqua: "We don't have to advertise. They find us."

That said, Beitner has also taken advantage of old ties when building the investment team. He'd known Michael Mow, who joined Chautauqua in its first year, since they were members of the same CFA study group in the 1980s. Mow was at TCW when Beitner and Bickerstaff joined in 1998, and they kept in touch. "When Michael was considering retiring and moving to Colorado," Beitner says, "I said, 'Colorado, yes. Retiring, no.'"

Haicheng Li, who joined in 2016, is the most recent addition to the team. However, Beitner had hired her at TCW 14 years earlier, first as an intern, then as a healthcare analyst. Meanwhile, David Lubchenco, who first came to Chautauqua in 2012 and then returned in 2016 after a stint at Marsico Capital Management, had his own ties to Transamerica, where he was involved with a strategy similar to Chautauqua's.

A Broader Platform

The firm remained independent for its first seven years, but Beitner found running a business an unwelcome distraction from time spent on investment research.

That's where Milwaukee-based financial-services firm Baird comes in. In early 2016, Chautauqua was acquired by the employee-owned company, which has earned a Positive rating on the Parent Pillar component of the Morningstar Analyst Rating owing to its investment culture, manager retention, and low fees, among other strengths.

"Baird distinguished itself as a superior culture and a good fit," Beitner says. "Each of us became enamored with them, and they have exceeded our expectations."

Baird Advisors, which runs the company's fixed-income strategies, has long been well-regarded. Three of its funds earn Morningstar Analyst Ratings of Silver, and the fixed-income team was nominated for Morningstar's Fixed-Income Manager of the Year award for 2016. (Baird Core Plus Bond BCOIX was featured in the magazine's April/May 2015 issue, and Mary Ellen Stanek, Baird Advisors CIO, in the April/May 2017 issue.)

The Chautauqua acquisition added international expertise to Baird's growing equity asset-management division. In turn, Chautauqua was able to hand over its middle- and back-office operations to Baird, which manages legal, human resources, payroll, and the like. Baird also broadened Chautauqua's reach by introducing mutual fund versions of the strategies: Chautauqua International Growth CCWIX and Chautauqua Global Growth CCGIX.

The arrangement allows Beitner to focus, unhindered, on what he does best: "Baird has wholly supported our autonomy over what goes in the portfolio and who's on the investment team."

Teamwork

What goes into the portfolios is very much a group effort from the team. While Beitner claims "final accountability for every name" as lead manager, he emphasizes that "every member of the team could take over the helm if necessary."

That's a change Beitner has made since his TCW days. "I was guilty of perpetuating the analyst model at TCW. That is flawed because the analyst is encouraged to persuade portfolio managers to buy a stock— and, therefore, accentuate the positive and underemphasize negatives."

At Chautauqua, all six members of the team are engaged in the process from idea generation through portfolio monitoring. It helps that all six were molded within the same philosophy. While Daniel Boston and Jesse Flores don't share the same roots as the other four team members, their talents were fostered right at Chautauqua. "Dan and Jesse came from other firms but quickly adapted," Beitner says. "Both had an ideal amount of experience; they were skilled in financial accounting and modeling but hadn't been indoctrinated in a different approach."

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Each of the six team members—all of whom are partners in the firm—brings specific skills to the group. Beitner's background, for example, includes public affairs and economics, so he specializes in analysis of macroeconomic trends. Boston has an accounting degree and had been a financial sector analyst. Beitner says, "He's the person we lean on when provisions and disclosures get murky."

Each of the six also has the expansive experience and interests of a generalist. When it comes to assigning a company for valuing and monitoring, Beitner says, "the Harvard medical school graduate [Li] might be in charge of a technology name, while the Cornell engineer [Flores] might do healthcare. What makes this doable is that we have concentrated portfolios of about seven securities per person, and we hold on average for five years."

Winnowing Down

The goal is a high-conviction portfolio of high-quality companies with competitive advantages that can benefit from long-term trends that promise to drive sustained high growth.

Brian Beitner, managing partner and lead portfolio manager at Chautauqua Capital Management.

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Chautauqua International Growth CCWIX

Morningstar Category	Foreign Large Growth
Expense Ratio (%)	0.95
Prospectus Benchmark	MSCI ACWI ex USA

Source: Morningstar. Data as of 04/30/2018.

Chautauqua Global Growth CCGIX

Morningstar Category	World Large Stock
Expense Ratio (%)	0.95
Prospectus Benchmark	MSCI ACWI

Source: Morningstar. Data as of 04/30/2018.

There are a couple of starting points. One is finding companies linked to key trends, which include a burgeoning middle class, aging populations, improved productivity and efficiency, information technology, and healthcare. Then, there are screens for companies with historical growth and profitability. Here, the team uses a variety of metrics, sometimes screening the entire market and sometimes narrowing in on sectors or countries. "Sometimes the data will surprise us and tip us off to a trend," Beitner says.

When a company meets both the trend and screening requirements, the team digs in. First, team members assess its competitive advantage, which may be rooted in its management, for example, or products. Then, they evaluate its quality, which is reflected in aspects such as conservative accounting, balance sheet strength, and shareholder alignment. Then, they consider the effects of where a company does business—its geographic footprint and currency exposure.

Valuation—forecasting cash profits and comparing those to the current cost of the business—is the last step in the stock-picking process, the point at which one team member takes responsibility for a name. At this step, a stock goes into the portfolio or onto the watchlist. "We don't want to eliminate interesting companies that might look expensive today," Beitner says, "so we only do detailed valuation on companies that have been thoroughly vetted."

When it comes to putting the pieces together, sector, country, and regional weightings are not tethered to a benchmark. The team considers correlations among sectors and similarities between countries. South Korea and Germany, for example, are both industrial exporters that are sensitive to currency movements, so may be more alike than their regional locations suggest. This nuanced analysis allows the team to manage portfolio risk without sacrificing best ideas simply because they fall into a certain sector or region. Team members are also mindful of currency impacts and prefer to manage exposure through security selection, as hedging can be expensive and complicated.

The goal is to mitigate risk with appropriate diversification, while remaining strictly selective about stocks. Chautauqua International Growth held only 29 stocks at the end of 2017, while Global Growth held 44—almost all the same foreign stocks, plus U.S. picks.

Picking and Sorting

Beitner holds up Chinese online travel agency Ctrip CTRP as an example of the process. As a result of a relaxation of travel restrictions and an aging population interested in new experiences, travel in China is a burgeoning trend. He believes that Ctrip is well-positioned to ride this trend, as it enjoys economies of scale and strong leadership and is a well-known trusted provider that appeals to new travelers.

Healthcare has been a relatively large weighting, reflecting the prospects of companies that have breakthrough or cost-containing products, including Novo Nordisk NVO, a leader in diabetes therapies and one of the largest positions as of year-end. More recently, the team has been adding financials that stand to benefit from rising rates, including Toronto-Dominion Bank TD:CA and Singapore-based DBS Group D05:SG. Global conglomerate Fanuc FANUY, the world's leading manufacturer of industrial automation equipment, was a first-quarter purchase. It is expected to benefit from a long-term trend toward automation, driven by labor shortages and wage inflation in the developed world.

The team regularly ranks the portfolio in terms of profitability, growth, and valuation, and assesses how adjusting positions would affect the overall risk profile. Team members may rebalance to achieve optimal conviction weights, or swap in new ideas. Anyone on the team can call for a review of a holding. An otherwise strong name might be sold for valuation reasons, to manage risk, or to take advantage of better opportunities.

Lululemon Athletica LULU is an example of both a successful investment and a sale of a company that no longer meets expectations. The team built a position when product problems created a controversy, but a new CEO promised a turnaround. The stock had a good run, but increased competition and the leader's abrupt departure led to a decision to take profits. The first-quarter sale of Italian oil and gas company Eni ENI:IT, as the CEO faces trial concerning a bribery scandal, reflects the team's emphasis on governance.

Governance is one aspect of the team's consideration of sustainability, which includes environmental and labor practices. "We believe that great businesses are good corporate citizens," Beitner says. "Companies that have labor strife or that run afoul of regulations can torpedo a portfolio." (His personal philanthropy reflects his awareness of environmental risks. He recently joined the board of Alliance for Climate Education, "an organization in Boulder, but with national scope. It does exciting work," educating teenagers on the science of climate change and solutions to the problem.)

The Long Haul

The mutual fund versions of the strategies have short but solid records. In 2017's rally, International Growth and Global Growth each landed in the top quartile of its Morningstar Category: foreign large growth and world large stock, respectively. While neither strategy is designed to outperform on the downside, both are near the norms for their category through April as markets have declined. Since the funds' inception in April 2016 through April 2018, International Growth is in line with its benchmark, the MSCI ACWI ex USA index, and Global Growth has handily beat the MSCI ACWI.

More revealing are the longer records of the corresponding separate accounts. Baird Chautauqua International Growth Equity's record dates to the beginning of 2006, and Baird Chautauqua Global Growth Equity's inception date is early 2007, so both have been through full market cycles involving dramatic ups and downs. Over the trailing 10 years through April, the International strategy returned an annualized 6.4%, well more than twice the 2.3% return of the MSCI ACWI ex USA. The Global strategy's annualized 10.1% return of that time nearly doubles the MSCI ACWI's 5.1% showing.

That long-term record was one of the factors leading to the inclusion of Baird Chautauqua International Growth in Morningstar Prospects, a collection of up-and-coming or under-the-radar strategies that do not have Analyst Ratings but that Morningstar's manager research analysts believe may be worth full coverage someday.

"Expect volatility here," warns senior analyst Greg Carlson, who oversees the Prospects list. Over the past three, five, and 10 years through April, the separate account composite has earned High Morningstar Risk Scores, which emphasize downside volatility. Beitner, however, notes that the International Growth strategy's downside capture relative to benchmark MSCI ACWI ex USA is comparable to that of its typical peer, which Morningstar's calculations bear out.

Either way, Carlson says that "investors have been well-compensated for the risk." The strategy compares favorably to other foreign large-growth strategies even on risk-adjusted returns, as reflected in its 4-star Morningstar Rating as of April. Meanwhile, the Baird Chautauqua Global Growth Equity separate account composite, which also has High risk scores, earned 5 stars.

A Good Fit

The Baird acquisition brought Chautauqua to the attention of the advisors at The Ragen Group, which is part of Baird's private wealth management business. The seven-person team based in Seattle oversees more than $2 billion in assets. Client accounts are invested primarily in individual stocks and bonds, but foreign stocks were stretching the advisors' bandwidth. Chautauqua International Growth Fund enabled them to diversify their portfolios in a manner that accorded with their own concentrated stock-picking philosophy.

"We did not want to own an extensive index fund," says Cam Ragen, financial advisor and managing director of the group. "We wanted to find a manager with the courage of their convictions. We believe that over time, active management creates healthy returns."

Vice president and financial advisor Phil Banta notes that their own stock-picking approach is more value-oriented than Chautauqua's but says that the strategies are more similar than not, given that both take a concentrated approach with a long-term orientation. "We did due diligence with other international strategies, too. At the end of the day, Chautauqua's philosophy and approach was most similar to how we invest. They feel like an extension of our team, so this was a good fit for us and our clients."

For its part, the Chautauqua team appreciates the opportunity to work with a select group of clients who understand the strategy and intend to stick with it. That's another freedom that the firm's alliance with Baird preserved: Chautauqua sets a limit on the number of clients that members of the investment team regularly engage with. It's a deliberate balance. "We know that retirement benefits are hard-earned and that endowments have noble goals, so it's important for us to know our clients," Beitner says. "But we also want to spend most of our time on investments."

Chautauqua also has the right to decide when to close strategies to new clients. Beitner is aware of the risks that come with outgrowing capacity, but he figures the danger point at north of $20 billion in assets given the firm's focus on large, liquid companies. Morningstar's Carlson considers the International Growth strategy "still quite nimble" with less than $600 million in assets, including the mutual fund. While that strategy has significant overlap with the Global Growth, the two together are under $1 billion.

No new products are on the horizon. "We'd need to get to scale in these current strategies before we'd even think about that," laughs Beitner. Clients and fund shareholders can expect Chautauqua to maintain its strict focus. M

Laura Lallos is managing editor of *Morningstar* magazine.

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The statements and opinions expressed here are current as of the date of the interview and are subject to change. The opinions of the author are not necessarily those of Baird. This is not a complete analysis of every material fact that should be considered when making an investment decision. References to any individual companies, industries or securities should not be regarded as an investment recommendation.

The Morningstar Analyst Rating Parent Pillar component is measured from a qualitative and quantitative perspective on a scale of positive, neutral and negative. Morningstar evaluates funds based on five key pillars--Process, Performance, People, Parent, and Price. Analysts assign a rating of Positive, Neutral, or Negative to each pillar. Analyst Rating Scale - Gold: Best-of-breed fund that distinguishes itself across the five pillars and has garnered the analysts' highest level of conviction. Silver: Fund with advantages that outweigh the disadvantages across the five pillars and with sufficient level of analyst conviction to warrant a positive rating. Bronze: Fund with notable advantages across several, but perhaps not all, of the five pillars.

The mutual funds have not been in existence long enough to qualify for Morningstar's star-rating methodology, but in 2017 both the Institutional Class of the Chautauqua Global Growth Fund and Chautauqua International Growth Fund were ranked by Morningstar in the top quartile of their categories (based on performance) out of 853 funds in the US Fund World Large Stock and out of 426 funds in the US Fund Foreign Large Growth, respectively.

For the strategies, Morningstar calculates a Morningstar Rating based on total returns that have not been adjusted for investment management fees. As of March 31, 2018, Chautauqua International Growth received 4 stars overall (amongst 166, 134 and 97 peers over a one-, five- and ten-year period) in the US Fund Foreign Large Growth category. Chautauqua Global Growth received 5 stars overall (amongst 461, 363 and 223 peers over a one-, five- and ten-year period) in the US Fund World Large Stock category. The top 10% of each category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and the bottom 10% receive 1 star.

Weightings in the Funds as of March 31, 2018: Ctrip – Global 0.92%; International 1.29%; Novo Nordisk – Global 2.78%; International 4.65%; Toronto-Dominion – Global 3.13%; International 4.69%; DBS Group – Global 2.15%; International 4.84%; Fanuc – Global 0.98%; International 0.99%; LULU – 0%; Eni – 0%.

The Chautauqua Capital Management Strategies are available to institutions and persons with a minimum account asset value of $50,000,000, which is negotiable in certain circumstances.

Strategy Performance

As of March 30, 2018, the one-year, five-year and ten-year net of fee performance of Chautauqua Global Growth was 25.75%, 13.68% and 9.74%, respectively. As of March 30, 2018, the one-year, five-year and ten-year performance of MSCI ACWI Index®-Gross Dividends was 15.44%, 9.79% and 6.15%, respectively.

As of March 30, 2018, the one-year, five-year and ten-year net of fee performance of Chautauqua International Growth was 25.67%, 9.65% and 6.20%, respectively. As of March 30, 2018, the one-year, five-year and ten-year performance of MSCI ACWI ex-US Index®-Gross Dividends was 17.05%, 6.37% and 3.17%, respectively.

The performance figures include transaction costs and accrued income and dividends. Gross of fee returns do not reflect the deduction of investment advisory fees. Net of fee performance was calculated using actual fees paid by clients. Advisory fees incurred by clients will vary. Other fees and expenses charged to an account will also reduce returns. Results are calculated in U.S. dollars.

Please visit chautauquacapital.com for performance current to the most recent quarter-end.

Mutual Fund Performance

As of March 30, 2018, the one-year and since inception (4/15/16) performance of the Institutional Class of the Chautauqua International Growth Fund was 18.27% and 14.71%, respectively. As of March 30, 2018, the one-year and since inception (4/15/16) performance of MSCI ACWI ex-US Index®-Net Dividends was 16.53% and 14.10%, respectively.

As of March 30, 2018, the one-year and since inception (4/15/16) performance of the Institutional Class of the Chautauqua Global Growth Fund was 20.37% and 18.69%, respectively. As of March 30, 2018, the one-year and since inception (4/15/16) performance of MSCI ACWI Index®-Net Dividends was 11.84% and 13.80%, respectively.

Please visit bairdfunds.com for performance current to the most recent month-end.

The gross expense ratios of the Institutional Class of the Chautauqua International Growth Fund and Chautauqua Global Growth Fund are 1.21% and 2.26%, respectively, but Baird has contractually agreed to limit each of the fund's annual fund operating expenses to 0.95% of average daily net assets at least through April 30, 2019.

Benchmark Definitions

The MSCI ACWI Index® is a free float-adjusted market capitalization weighted index that is designed to measure the equity performance of developed and emerging markets. The MSCI ACWI Index® consists of 44 country indices, including the United States, comprising 23 developed and 21 emerging market indices. The MSCI ACWI ex-US. Index® is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets excluding the United States. A direct investment in an index is not possible. The gross of dividend index returns are gross of dividend withholding taxes.

Performance data quoted represents past performance. Past performance does not guarantee future results. Investment return and principal value of an investment in the fund will fluctuate so that an investor's shares when redeemed may be worth more or less than their original cost. The fund's current performance may be lower or higher than the performance data quoted. Performance figures assume reinvestment of all dividends and capital gains and are annualized for periods greater than one year. A direct investment in an index is not possible.

Investors should consider the investment objectives, risks, charges and expenses of each mutual fund carefully before investing. This and other information is found in the prospectus and summary prospectus. For a prospectus or summary prospectus, contact Baird directly at 866-442-2473 or contact your Financial Advisor.

For additional important information about the fees, expenses, risks and terms of investment advisory accounts at Baird, please review Baird's Form ADV Brochure, which can be obtained from your financial advisor and should be read carefully before opening an investment advisory account. You may also visit the www.bairdassetmanagement.com webpage. Please read the prospectus, summary prospectus or Form ADV Brochure carefully before investing.

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