Baird Aggregate Bond Inst BAGIX

Checks all the right boxes.

Morningstar's Take BAGIX

Morningstar Rating	★★★★
Morningstar Analyst Rating	Gold

Morningstar Pillars

Process	Positive
Performance	Positive
People	Positive
Parent	Positive
Price	Positive

Role In Portfolio
Core

Fund Performance BAGIX

Year	Total Return (%)	+/- Category
YTD	1.30	-0.11
2018	-0.30	0.19
2017	4.20	0.49
2016	3.52	0.29
2015	0.55	0.81

Data through 2-28-19

2-25-19 | by Alaina Bompiedi

A cohesive team, proven and deliberative process, and low fees position Baird Aggregate Bond for long-term success, supporting an upgrade of the strategy's Morningstar Analyst Rating to Gold from Silver.

Lead manager and Baird CIO Mary Ellen Stanek heads a veteran team of five portfolio managers that have worked at Baird for nearly two decades. They are supported by five additional portfolio managers, 12 dedicated analysts, and a handful of other tenured players that assist with research and risk management. While this outfit is somewhat smaller than other firms', it sticks to investments that it can research thoroughly.

Stanek and team curate a portfolio of mainly investment-grade corporate credit, securitized debt, and U.S. government bonds--the primary sectors of the Bloomberg Barclays U.S. Aggregate Bond Index benchmark. The team matches the fund's duration to the index's, while avoiding derivatives, leverage, and esoteric fare, and using high yield minimally.

For most of the strategy's life, it has maintained persistent overweightings to corporate and securitized bonds and downplayed U.S. Treasuries, which has given it a slight yield advantage over the benchmark. To balance that additional credit risk, the team emphasizes diversification and position sizing as risk controls. High-conviction bets on benchmark names are kept within 75 basis points of the benchmark's sizing, and industry over- and underweightings are kept within a handful of percentage points. That risk-aware approach prevents the fund from getting thrown off course by any one bet.

The strategy's slight overweighting in credit can cause it to underperform its Treasury-heavy index when credit sells off, but attentive risk management has kept it from major missteps. The fund's low fees also help discourage outsize risk-taking. From its inception in 2000 through January 2019, it returned 5.2%, landing in the intermediate-term bond Morningstar Category's best quartile.

Process Pillar Positive | Alaina Bompiedi 02/25/2019

Mary Ellen Stanek and her team have plied a straightforward and risk-conscious approach here for nearly two decades. They seek value through sector rotation and security selection among investment-grade corporate bonds, securitized debt, and U.S. Treasuries, while keeping the fund's duration in line with that of its Aggregate Index benchmark. They avoid derivatives, foreign currency, and leverage.

In most markets, the team tries to outrun the benchmark with corporate credit--typically 30%-45% of assets (usually about 15 percentage points higher than the index's exposure). It attempts to mitigate that credit risk through diversification and position sizing guardrails. All securities in the fund must be investment-grade at the time of purchase, but the team will hold on to downgraded holdings, such as its legacy nonagency mortgages, which were downgraded in the financial crisis. As of December 2018, the strategy held just 0.5% in below-investment-grade debt compared with the intermediate-bond category average of 6%.

All members of the team source, analyze, and secure investments for the portfolio. While the team's resources may not match the breadth of larger firms, it stays within its circle of competence and has proactively added tools and headcount to deepen its research. This straightforward, cohesive process has served investors well, supporting a Positive Process rating.

Compared with the Aggregate Index, this strategy tends to carry an overweighting in corporate credit while downplaying U.S. government bonds. Over the trailing 10 years, corporates and securitized debt, including agency mortgage-backed securities and structured credit sectors, have comprised the majority of the portfolio. As of Dec. 31, 2018, corporate bonds totaled 41%, while securitized debt totaled 34%. Those weightings were within their normal ranges, though tightening credit spreads (beginning in mid-2016) led the team to cut back the strategy's exposure to credit and increase its stockpiles in more-defensive agency residential MBS (22%) and U.S. Treasuries (22%).

While the strategy's predilection for corporate bonds imbues it with more credit risk than the benchmark, the team rarely makes bold bets on industries and sectors, let alone individual names. High-conviction corporate names are typically expressed as a 0.50- to 0.75-percentage-point overweighting relative to the index's sizing, and industry overweightings are kept within a few percentage points. In 2018, the team maintained a 2-percentage-point overweighting in the energy sector versus the index, preferring the stable cash flows of midstream companies and, to a lesser extent, refining. However, the team cut back its exposure to commodity-sensitive exploration and production companies, concerned about volatility in energy prices.

Performance Pillar Positive | Alaina Bompiedi 02/25/2019

From the strategy's 2000 inception through January 2019, its 5.2% annualized return outpaced its Aggregate Index benchmark by 47 basis points and 75% of its distinct intermediate-bond category peers. On a volatility-adjusted basis, as measured by Sharpe ratio, the strategy's performance outran 85% of its competitors. Those strong long-term results support a Performance rating of Positive.

The strategy's credit-heavy bias has given it an advantage over the long haul, but it can also be a source of short-term volatility when credit markets dive. During the 2008 financial crisis, the strategy lagged its index and peers even as management dialed back the corporate stake to 30% (still 7 percentage points higher than the Aggregate Index's exposure), in part owing to weakness in its nonagency mortgage holdings. That year, the fund lost 2.4%, not as severe as some peers but nearly 7 percentage points behind the index's 5.2% gain.

Yet the team's prudent approach toward diversification, its tendency to stay higher in issuers' capital structure, and its preference for shorter-dated fare when it ventures down in credit quality, have helped insulate performance through other volatile stretches. During 2018, a challenging year that contained both interest-rate and credit-driven volatility, the strategy's 0.30% loss was a smidgen higher than the category's median loss of 0.35%.

People Pillar Positive | Alaina Bompiedi 02/25/2019

In her capacity as chief investment officer of Baird Advisors, Mary Ellen Stanek has helped align this team's incentives with shareholders' while fostering a tight-knit, collaborative approach. Seasoned leadership supported by an effective team earn a Positive People Pillar rating.

Stanek heads a five-member portfolio management team that collaborates on the firm's taxable-bond strategies, including Baird Short-Term Bond BSBIX and Baird Core Plus Bond BCOIX. Averaging 35 years of industry experience, the leadership roster has remained consistent since the strategy's inception. Four additional senior portfolio managers--with credit research, securitized research, and portfolio risk focuses--and 12 dedicated analysts lend support.

The team's strengths lie in its experienced leadership bench, cohesive culture, and mindfulness about its limitations. This team does not pursue highly credit-sensitive or esoteric investments that would require resources beyond those that currently exist to support the strategies. Stanek has also been proactive in adding resources, making four new hires between 2017 and 2018 and beginning an expansion of the team's tools and technology.

While many of the senior leaders on this bench are far along in their careers, the team doesn't foresee immediate changes to its leadership ranks, and mid-level staff is well-positioned to take the reins in the future.

Parent Pillar Positive | Alaina Bompiedi 03/21/2018

Baird is an employee-owned, financial-services firm that provides investment banking, private wealth advising, and asset-management services. Its asset-management business comprises fixed-income-focused Baird Advisors and Baird Equity Asset Management. Baird Advisors oversees 95% of the firm's mutual fund assets under management, and its leader, Mary Ellen Stanek, also acts as Baird's CIO, bringing the interests of her group to Baird's senior leadership.

Over the past several years, the firm's assets under management have grown substantively and quickly. Today, Baird's asset-management group oversees roughly $65 billion, with $50 billion in mutual funds (up from less than $10 billion five years ago). Although rapid growth can sometimes raise concern, Baird has responded by adding to its investment team and technological resources. Further, Baird Advisors increased the minimum size of its separate accounts to $100 million to slow the pace of inflows.

Meanwhile, Baird Advisors has long maintained low fees overall. Its compensation structure also helps mitigate key-person risk, aligns personnel's financial success with the success of the fund lineup, and has resulted in strong manager retention. Baird's equity shelf is modest, but growing: In 2016, the firm added an international and a global fund to its lineup with the acquisition of Chautauqua Capital Management. Overall, the firm earns a Positive Parent rating.

Price Pillar Positive | Alaina Bompiedi 02/25/2019

About 95% of the fund's assets are held in its Institutional share class, BAGIX, which charges a low fee of 0.30% (excluding additional investment-related costs) that puts it in competition with some index funds. The Retail share class BAGSX charges 0.55%, below many of its no-load competitors. Compelling fees earn a Positive Price Pillar rating.

Important Disclosure Information

Analyst Rating is the summary expression of Morningstar's forward-looking analysis of a fund. Morningstar analysts assign the ratings on a five-tier scale with three positive ratings of Gold, Silver, and Bronze, a Neutral rating, and a Negative rating. The Analyst Rating is based on the analyst's conviction in the fund's ability to outperform its peer group and/or relevant benchmark on a risk-adjusted basis over the long term. If a fund receives a positive rating of Gold, Silver, or Bronze, it means Morningstar analysts think highly of the fund and expect it to outperform over a full market cycle of at least five years. The Analyst Rating is not a market call, and it is not meant to replace investors' due-diligence process. It cannot assess whether a fund is the right fit for a particular portfolio and risk tolerance. 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 Morningstar four-star rating for the Institutional Class Baird Aggregate Bond Fund is the overall rating received among 879 Intermediate-Term Bond Funds. The fund received three stars for the three-year period among 879 Intermediate-Term Bond Funds, four stars for the five-year period among 767 Intermediate-Term Bond Funds and four stars for the ten-year period among 564 Intermediate-Term Bond Funds, as of February 28, 2019.

The overall Morningstar Rating for a fund is derived from a weighted average of the performance figures associated with a fund’s three-, five- and ten-year (if applicable) Morningstar Rating metrics.

For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating based on a Morningstar Risk- Adjusted Return measure that accounts for variation in a fund’s monthly performance (including the effects of sales charges, loads and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive five stars, the next 22.5% receive four stars, the next 35% receive three stars, the next 22.5% receive two stars and the bottom 10% receive one star. Each share class is counted as a fraction of one fund within this scale and rated separately, which may cause slight variations in the distribution percentages. Past performance is no guarantee of future results.

The average annual total returns for the Institutional Class of the Baird Aggregate Bond Fund as of December 31, 2018 are -0.30% for the one-year, 2.94% for the five-year and 4.78% for the ten-year periods and 5.12% since its September 29, 2000, inception date. The expense ratio of the Institutional Class is 0.30%.

The average annual total returns for the Barclays US Aggregate Bond Index as of December 31, 2018 are 0.01% for the one-year, 2.52% for the five-year and 3.48% for the ten-year periods and 4.65% since the fund’s inception.

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. Investment results assume all distributions are reinvested and reflect applicable fees and expenses. For performance current to the most recent month-end, please visit bairdfunds.com.

The Barclays U.S. Aggregate Bond Index is a fixed income, market- value index generally representative of investment grade fixed-rate debt issues, including government, corporate, asset-backed, and mortgage-backed securities with maturities of at least one year. Indices are unmanaged and are not available for direct investment.

The Fund may invest in mortgage- and asset-backed securities which may be subject to prepayment risk and thus may be more sensitive to interest rate changes than other types of debt securities. The Fund may also invest in U.S. dollar denominated securities issued by foreign issuers which involve additional risks including political and economic instability, differences in financial reporting standards and less regulated securities markets. While the U.S. government has historically provided financial support to various U.S. government-sponsored agencies, no assurance can be given that it will do so in the future if it is not obligated by law. A bond's market value may be affected significantly by changes in interest rates – generally, when interest rates rise, the bond's market value declines and when interest rates decline, its market value rises ("interest-rate risk"). Duration risk is the risk associated with the sensitivity of a bond's price to a one percent change in interest rates. Ratings are measured on a scale that ranges from AAA or Aaa (highest) to D or C (lowest). Investment grade investments are those rated from highest down to BBB- or Baa3

Investors should consider the investment objectives, risks, charges and expenses of the fund carefully before investing. This and other information is found in the prospectus and summary prospectus. For a prospectus or summary prospectus or for performance current to the most recent month-end, please visit www.bairdfunds.com contact Baird Funds directly at 800-444-9102 or contact your Baird Financial Advisor. Please read the prospectus or summary prospectus carefully before investing. The fund’s current performance may be lower or higher than this performance data.

This reprint must be accompanied with performance data current through the most recent quarter. For Morningstar ratings data and Fund holdings current through the most recent month-end, as well as credit quality profile current through the most recent quarter-end, please visit www.bairdfunds.com.