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Baird Short-Term Bond Inst BSBIX

No-nonsense and sensible exposure to short-term bonds.

Morningstar's Take BSBIX

Morningstar Rating	★★★★
Morningstar Analyst Rating	Gold

Morningstar Pillars

Process	High
Performance	—
People	Above Average
Parent	Above Average
Price	—

Role In Portfolio

Supporting Player

Fund Performance

Year	Total Return (%)	+/- Category
YTD	-0.01	-0.14
2020	4.23	0.42
2019	4.68	-0.04
2018	1.49	0.57
2017	1.53	-0.20

Data through 1-31-21

2-11-21 | by Gabriel Denis

The same core of talented managers on Baird Short-Term Bond, supported by a growing group of collaborators, has helmed this strategy capably for over 15 years. A disciplined investment process, supported by low fees, earns a Morningstar Analyst Rating of Gold for this strategy's cheaper share class and Silver for its pricier option.

Lead manager and Baird CIO Mary Ellen Stanek heads a well-tenured, eight-person portfolio management team made up of four strategic leaders and four midlevel directors--most of this group has worked together since the strategy's inception in August 2004. Stanek's supporting cast continues to grow, boasting five structured and seven corporate credit analysts at the end of 2020. Although not as grand as some of the firm's largest competitors, the group is deeply collaborative and sticks to investments it can research thoroughly and confidently.

The team's no-nonsense approach focuses on investment-grade corporates, high-quality securitized credit, and government bonds and keeps the strategy's duration in line with that of the Bloomberg Barclays U.S. Government/Credit 1-3 Year Index. The process forgoes leverage, derivatives, and macro trades, while its duration-neutral style allows management to focus on security selection and sector rotation. The strategy maintains a persistent bias toward investment-grade corporate credit (55% of the portfolio as of December 2020), making it more sensitive to credit risk than the benchmark. But the team balances that risk with judicious credit selection and diversification, emphasizing large, liquid names and keeping position overweightings within 75 basis points of their benchmark size.

Although the team's long-term record is middling relative to aggressive peers in the short-term bond Morningstar Category, their circumspect approach has generally worked in the strategy's favor in stressful markets. When credit markets collapsed amid the coronavirus, its 2.9% drop from Feb. 20 through March 23, 2020, was less severe than two thirds of its rivals.

Process Pillar High | Gabriel Denis 02/11/2021

The managers have maintained the same structured and thoughtful investment process for just shy of two decades. While the team's resources may not match the scope of larger rivals, it stays well within its guardrails and has proactively added tools and headcount to maintain its edge. This straightforward, comprehensive, and investor-friendly approach earns a High Process Pillar rating.

The team uses the Bloomberg Barclays U.S. Government/Credit 1-3 Year Index as a guide for sector rotation and security selection across investment-grade corporates, securitized fare (both agency mortgages and nonagency, high-quality securitizations), and government bonds. They keep the strategy's duration identical to that of the benchmark's, and derivatives, foreign currency, and leverage are off-limits. These restrictions allow the team to focus and refine its research in the core areas of the portfolio.

This team takes risk through credit rather than interest rates, which has led to bold stakes in BBB fare (30% of the portfolio as of December 2020). But that risk is mitigated through diversification; the highest-conviction positions are capped at a maximum 75-basis-point overweighting relative to the index, and no individual name can go above 5% of the portfolio. When the team wants to add credit risk, it prefers well-trafficked corporate bonds or AAA rated credit card or auto-loan asset-backed securities.

Although management focuses on investment-grade bonds here, the strategy remains far more opportunistic than its U.S. Treasury-heavy index. The strategy's corporate bond position has been, on average, more than double in size its bogy over the decade ended December 2020. The stake peaked over the period at 83% in 2011, but the managers have since moderated this exposure as corporate spreads have tightened. It sat at 51% as of December 2020, down from a midyear peak of 58% as the managers sold into a frothy rally in credit. While the vast majority of their stake was investment-grade, the managers were willing to hold on to several major fallen angels, including Ford Motor Company F and Occidental Petroleum OXY, where they believed the underlying fundamentals were still solid. This contributed to the strategy's overall high-yield debt allocation climbing to 2% from less than a half-percent a year earlier.

While corporates and U.S. Treasuries (33%) make up the lion's share of assets, the team has long held a positive view of several flavors of high-quality securitized credit. The strategy's stake in asset-backed securities (6%) included short-dated American Express- and Capital One-linked credit card securitizations purchased in the wake of the March 2020 sell-off when widening spreads made them look particularly attractive.

Performance Pillar | Gabriel Denis 02/11/2021
An overweighting in investment-grade credit has helped the strategy outperform its Bloomberg Barclays U.S. Government/Credit 1-3 Year Index since its August 2004 inception with modest volatility (measured by standard deviation). From September 2004 through January 2021, its risk-adjusted return, as measured by the Sharpe ratio, was higher than around 80% of distinct short-term bond Morningstar Category peers. Yet the strategy’s trailing total returns over the same period are somewhat less impressive, with its 2.9% annualized return comfortably outpacing its index but landing in the middle of its peer group.

The strategy’s large corporate bond stake has helped it beat its Treasury-heavy benchmark over the trailing 10 years, but its conservative bent has held back performance relative to riskier peers. When credit markets have buckled, as during the 2008 financial crisis, its credit-heavy tilt can cause it to lag its index, while its quality bias has typically buoyed it above the average competitor. For instance, the fund held up better than over 70% of its rivals when falling oil prices pushed credit spreads wider from June 2015 through February 2016. When the coronavirus compelled a credit market collapse between Feb. 20 and March 23, 2020, the strategy held up better than two thirds of its cohort.

People Pillar ● Above Average | Gabriel Denis 02/11/2021
While lacking the goliath analyst benches of some of the larger players in the fixed-income space, the nimble team helming this strategy benefits from seasoned leadership and a tight-knit, collaborative investment culture. It earns an Above Average People Pillar rating.

Baird Advisors CIO Mary Ellen Stanek heads a well-tenured, eight-person portfolio management team made up of four members of the strategic leadership team and four midlevel leaders. Five of these eight have been listed on the strategy since its August 2004 inception date, with a further three added over 2019. Her supporting roster of analysts, including five structured, seven credit, and four risk analysts, has continued to grow, with three joining the firm over the course of 2020.

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 expanding both the team’s roster and resources. While many of the senior leaders on this bench are far along in their careers, the naming of several midlevel leaders to the strategy suggests they are well-positioned to take the reins in the future should any top-level changes occur.

Parent Pillar ● Above Average | Gabriel Denis 03/31/2020
Baird's strength in its large fixed-income business and investor-friendly stewardship merit an Above Average Parent rating.

Under the leadership of longtime CIO Mary Ellen Stanek, the firm's taxable-bond funds continue to impress. Boasting low fees, a well-resourced team, and risk-aware investment processes, they constitute over 90% of the firm's assets under management, expanding from $37 billion in 2016 to nearly $88 billion at the end of 2019. This growth bears monitoring, but the team has shown prudence in adding personnel and operational resources to manage this burgeoning load. In recent years, the group has also focused on building out its municipal-bond effort, adding several key members to the team and launching two new municipal strategies in mid-2019. Although the firm's equity enterprise is smaller, it too benefits from tenured managers and attractive fees.

The firm's private wealth management arm has also grown precipitously in recent years, most recently through the acquisition of Louisville, Kentucky-based Hilliard Lyons in 2019. When framing the growth of this organization, Baird emphasized that Hilliard Lyons' advisors fit the cultural profile of its organization. This cultural fit is important: Turnover among the firm's analyst staff has historically been low, and around two thirds of employees owned stock in the firm at the end of 2019.

Price Pillar | Gabriel Denis 02/11/2021
It’s critical to evaluate expenses, as they come directly out of returns. The share class on this report levies a fee that ranks in its Morningstar category’s cheapest quintile. Based on our assessment of the fund’s People, Process and Parent pillars in the context of these fees, we think this share class will be able to deliver positive alpha relative to the category benchmark index, explaining its Morningstar Analyst Rating of Gold.

Important Disclosure Information

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. For performance current to the most recent month-end, please visit bairdfunds.com. Carefully consider a fund's investment objectives, risks, charges, and expenses before investing. For a current prospectus and summary prospectus, containing this and other information, visit bairdfunds.com. Read it carefully before investing.

The Morningstar Analyst Rating™ is not a credit or risk rating. It is a subjective evaluation performed by Morningstar's manager research group, which consists of various Morningstar, Inc. subsidiaries ("Manager Research Group"). In the United States, that subsidiary is Morningstar Research Services LLC, which is registered with and governed by the U.S. Securities and Exchange Commission. The Manager Research Group evaluates funds based on five key pillars, which are process, performance, people, parent, and price. The Manager Research Group uses this five-pillar evaluation to determine how they believe funds are likely to perform relative to a benchmark over the long term on a risk adjusted basis. They consider quantitative and qualitative factors in their research. For actively managed strategies, people and process each receive a 45% weighting in their analysis, while parent receives a 10% weighting. For passive strategies, process receives an 80% weighting, while people and parent each receive a 10% weighting. For both active and passive strategies, performance has no explicit weight as it is incorporated into the analysis of people and process; price at the share-class level (where applicable) is directly subtracted from an expected gross alpha estimate derived from the analysis of the other pillars. The impact of the weighted pillar scores for people, process and parent on the final Analyst Rating is further modified by a measure of the dispersion of historical alphas among relevant peers. For certain peer groups where standard benchmarking is not applicable, primarily peer groups of funds using alternative investment strategies, the modification by alpha dispersion is not used.

The Analyst Rating scale is Gold, Silver, Bronze, Neutral, and Negative. For active funds, a Morningstar Analyst Rating of Gold, Silver, or Bronze reflects the Manager Research Group's expectation that an active fund will be able to deliver positive alpha net of fees relative to the standard benchmark index assigned to the Morningstar category. The level of the rating relates to the level of expected positive net alpha relative to Morningstar category peers for active funds. For passive funds, a Morningstar Analyst Rating of Gold, Silver, or Bronze reflects the Manager Research Group's expectation that a fund will be able to deliver a higher alpha net of fees than the lesser of the relevant Morningstar category median or 0. The level of the rating relates to the level of expected net alpha relative to Morningstar category peers for passive funds.

For certain peer groups where standard benchmarking is not applicable, primarily peer groups of funds using alternative investment strategies, a Morningstar Analyst Rating of Gold, Silver, or Bronze reflects the Manager Research Group's expectation that a fund will deliver a weighted pillar score above a predetermined threshold within its peer group. Analyst Ratings ultimately reflect the Manager Research Group's overall assessment, are overseen by an Analyst Rating Committee, and are continuously monitored and reevaluated at least every 14 months.

For more detailed information about Morningstar's Analyst Rating, including its methodology, please go to https://shareholders.morningstar.com/investor-relations/governance/Compliance--Disclosure/default.aspx.

The Morningstar Analyst Rating (i) should not be used as the sole basis in evaluating a fund, (ii) involves unknown risks and uncertainties which may cause the Manager Research Group's expectations not to occur or to differ significantly from what they expected, and (iii) should not be considered an offer or solicitation to buy or sell the fund.

The Morningstar four-star rating for the Institutional Class Baird Short-Term Bond Fund is the overall rating received among 521 Short-Term Bond Funds. The fund received three stars for the three-year period among 521 Short-Term Bond Funds, three stars for the five-year period among 465 Short-Term Bond Funds and four stars for the ten-year period among 303 Short-Term Bond Funds, as of January 31, 2021.

The Morningstar Rating™ for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The Morningstar Rating does not include any adjustment for sales loads. The top 10% of products in each product 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.

The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods.

The average annual total returns for the Institutional Class of the Baird Short-Term Bond Fund as of December 31, 2020, are 4.23% for the one-year, 2.83% for the five-year and 2.40% for the ten-year periods and 2.88% since its August 31, 2004, inception date. The expense ratio of the Institutional Class is 0.30%.

The average annual total returns for the Barclays 1-3 U.S. Government/Credit Bond Index as of December 31, 2020, are 3.33% for the one-year, 2.21% for the five-year and 1.60% for the ten-year periods and 2.46% since the fund’s inception.

The Bloomberg Barclays 1-3 U.S. Government/Credit Bond Index is an index consisting of Treasury or government agency securities and investment grade corporate debt securities with maturities of one to three years. 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.

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.