

# Baird MidCap Inst BMDIX

Steady.

## Morningstar's Take BMDIX

**Morningstar Rating** ★★★★★

**Morningstar Analyst Rating** Bronze

### Morningstar Pillars

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

### Role In Portfolio

Supporting Player

### Fund Performance

Year	Total Return (%)	+/- Category
YTD	4.45	0.85
2019	36.31	3.79
2018	-1.61	5.04
2017	26.88	2.97
2016	5.40	-0.63

Data through 6-30-20

7-14-20 | by Stephen Welch

Baird MidCap's experienced management team and straightforward approach earn it a Morningstar Analyst Rating of Bronze across all share classes.

Seasoned managers run the show here. Lead manager Charles Severson has overseen the fund since its year-end 2000 inception and a similar separate account dating to 1993. Comanager Kenneth Hemauer has worked on the fund since the beginning as an analyst, becoming a named manager in mid-2010. Four analysts round out the team, three of whom have over a decade of experience with the fund.

Severson's process is disciplined and time-tested. Focused on profitable firms within the market-cap range of the Russell Midcap Index, he looks for companies like longtime holding Fastenal FAST. It is the largest fastener distributor in North America with a low debt/capital ratio and an above-

benchmark return on invested capital. Its stock has outpaced the index by almost 4 percentage points annualized since he first purchased it in late 2002. While fundamental analysis is key to identifying such companies, Severson and his team also use quantitative and technical overlays for position sizing and transaction decisions.

Severson often pays up for growth in building the fund's portfolio of roughly 55 to 60 stocks. Over the past decade, the fund's trailing 12-month price/earnings ratio ranged between 18 and 34 and was on average 16% higher than the Russell Midcap Growth Index's. Even when the kind of profitable, debt-light firms Severson favors can be had at a bargain, he is cautious about buying companies on his roughly 10-stock watch list. For example, he waited for O'Reilly Automotive ORLY to resolve its sales issues in 2017 before buying the stock at a higher price in early 2018.

The fund's quality tilt has buoyed it in down markets like early 2020's coronavirus-driven plunge, but it can lag during extended rallies. Yet, over Severson's 19-plus years in charge, the institutional shares' 8.2% annualized gain through June 2020 beat the Russell Midcap Growth Index's 7.7%.

This fund continues to be a strong option.

**Process Pillar** Average | Stephen Welch 07/13/2020

Although straightforward and well-executed, the fund's use of Street research and tight sector constraints drop its Process rating to Average from Above Average.

Focused on stocks within the Russell Midcap Index's market-cap range, manager Charles Severson and his team look for companies with five characteristics: attractive margins, durable revenue growth, capable management, industry tailwinds,

and favorable market expectations. The team pays attention to valuations, often using Street research to aid in the process, but isn't afraid to buy expensive but well-run growers. Overall, though, the fund typically favors profitable, debt-light firms that can sustain above-average earnings and revenue growth for at least three to five years.

The fund uses a quant screen as a fundamentals-check and a technical screen to gauge sentiment, which helps it time buying and selling. But it isn't beholden to those filters. Turnover isn't excessive, ranging between 30% and 60% since 2009. While most holdings take up 1% to 3% of assets, the fund can build up to a 4% position in firms with quant and technical screen support, and it holds on to them unless their growth slows.

The team is sector-aware, trying limit risk by keeping sector weightings to 75% to 125% of the Russell Midcap Growth Index's. Severson will sell names whose market caps become too big for the benchmark.

This fund is fairly diversified across 55-60 stocks, its typical range since mid-2008, with no more than a fourth of assets in its top 10 holdings. Still, the fund favors some sectors more than others, while shunning not-yet-profitable biotech firms and highly leveraged companies, including most REITs, utilities, and airlines. The fund also does not invest in unprofitable businesses, now about 10% of the index.

Charles Severson keeps a watchlist of roughly 10 stocks and will wait to buy a name from the list when the company's results improve. That entails paying up a bit for stocks. For example, he waited for O'Reilly Automotive to resolve its sales issues in 2017 before buying the stock in early 2018; by then, its share price had recouped somewhat. Indeed, the fund's average trailing 12-month price/

earnings has averaged 17% higher than the index's over the past five years.

Severson tempers price risk by sticking to high-quality fare. In the case of O'Reilly, Severson thinks its vendor-financed business model will generate enough cash to spur expansion and share buybacks. Overall, the fund's net margin levels have been higher and its debt/capital levels lower than the index's during his tenure. During the first quarter's coronavirus-driven uncertainty, Severson swapped out picks for greater balance-sheet strength, durability, and growth, along with reduced cyclicity.

**Performance Pillar** | Stephen Welch 07/13/2020

The fund has performed well under its longest-tenured manager, Charles Severson. Since his year-end 2000 start, the institutional shares' 8.2% annualized gain through June 2020 beat the Russell Midcap Growth Index's 7.7% and the typical mid-growth peer's 5.9%. The fund's Sortino ratio, a measure of risk-adjusted results, was also higher than the benchmark's during that stretch.

The fund got much of its edge from faring well in volatile markets, like the 2007-09 credit crisis. From the Russell Midcap Index's July 19, 2007, peak to its March 9, 2009, trough, the fund's painful 51% drop was still nearly 6 percentage points less than the benchmark's. A penchant for financially sturdy, steady growers like Fastenal helped then, as did timely sales of hard-hit energy and industrials names. The fund typically outperforms the index in market corrections, like in 2011's third quarter, 2012's second quarter, late 2018's drawback, and 2020's first-quarter plunge.

The fund can lag for extended periods, whether in rallies that favor more aggressive peers or value-oriented markets that reward the kind of income-oriented sectors it typically eschews. Treading lightly in real estate and utilities hurt from mid-2004 to mid-2007, for example, though poor restaurant picks, like Cheesecake Factory CAKE, also weighed on results then. The fund also finished behind the index in each calendar year from 2013-16.

**People Pillar** ● Above Average | Stephen Welch 07/13/2020

An experienced and effective management team earns the fund an Above Average People rating.

Charles Severson has been in charge since the fund's year-end 2000 inception, but his experience with the strategy goes beyond that. A 33-year veteran of Robert W. Baird & Co, Severson has used the same process on separate account Baird Mid-Cap Growth Equity since June 1993, and it successfully navigated the market drawbacks in 1998 and 2000. Kenneth Hemauer joined the fund in 2001 as a financials and consumer analyst and became a named manager in mid-2010. He still covers the financials sector.

The two managers work as part of a six-person team; all but one have worked together for over a decade. The industrials analyst and the healthcare analyst each came to the fund more than 10 years ago, with 20 and seven years of prior experience, respectively. The consumer analyst joined the team in mid-2014, after roughly four years on Baird's sell-side research team. There was a change to the technology analyst position in April 2019, but the new analyst who joined isn't a neophyte. He came with three years of investment experience and spent over a decade in the technology industry before that.

Hemauer has over \$1 million in the fund, while Severson's investment dropped below \$1 million as he moved some money into Baird Small/Mid Cap Growth BSGSX.

**Parent Pillar** ● Above Average | Gabriel Denis 03/31/2020

Baird's strength in its large fixed-income business and investor-friendly stewardship overall 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** | Stephen Welch 07/13/2020

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 second-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 Bronze.

## 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](http://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](http://bairdfunds.com). Read it carefully before investing.**

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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 of the Baird MidCap Fund is the overall rating received among 588 Mid Growth Funds. The fund received four stars for the three-year period among 588 funds, four stars for the five-year period among 500 Funds and four stars for the ten-year period among 381 Funds as of June 30, 2020.

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 MidCap Fund as of June 30, 2020, are 12.48% for the one-year, 11.66% for the five-year and 14.44% for the ten-year periods and 8.24% since its December 29, 2000, inception date. The expense ratio of the Institutional Class is 0.81%.

The average annual total returns for the Russell Midcap Growth Index as of June 30, 2020, are 11.91% for the one-year, 11.60% for the five-year and 15.09% for the ten-year periods and 7.69% since the fund's inception.

The Russell Midcap Growth Index measures the performance of those Russell Midcap companies with higher price-to-book ratios and higher forecasted growth values. The stocks are also members of the Russell 1000 Growth Index. Indices are unmanaged and are not available for direct investment.

The Fund focuses on growth-style stocks and therefore the performance of the Fund will typically be more volatile than the performance of funds that focus on types of stocks that have a broader investment style. The Fund may invest up to 15% of its total assets in U.S. dollar-denominated foreign securities and ADRs. Foreign investments involve additional risks such as currency rate fluctuations, political and economic instability, and different and sometimes less strict financial reporting standards and regulation. The Fund invests a substantial portion of its assets in the stocks of mid-capitalization companies. Mid-capitalization companies often are more volatile and face greater risks than larger, more established companies.

*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](http://www.bairdfunds.com).*

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