

### MARKET UPDATE

Most stock market averages marched higher in the first quarter of 2017, but the charge was primarily led by those segments of the market that lagged during last November's post-election euphoria. In fact, investors have become skeptical about the President's ability to cut taxes and boost infrastructure spending after the GOP healthcare bill failed in March. Although investors sold safe haven stocks and bonds after the election, those sectors such as utilities have outperformed so far this year as Treasury bond yields have fallen, reflecting the reality that economic growth and inflation may not be any stronger this year than before Trump took office.

Fueling the rotation, has been the reality that although many soft economic indicators such as confidence have levitated, the hard economic data has been mixed prompting many economists to lower their expectations for Q1 GDP from 2.5-3% down to just 1% or so. Corporate profits, on the other hand, are expected to fare better boosted in large part by the energy sector on the heels of a rebound in oil prices from early 2016 lows. Still, industrial and material companies, which helped lead the rally in November, are expected to post broad declines in earnings this quarter. In many cases, the gap between confidence and earnings growth could make some stocks vulnerable for a pullback.

We made the case in last quarter's commentary that brief periods of robust returns for cyclical, lower-quality stocks are followed by multi-year periods of outperformance by higher-quality equities with better earnings consistency. Since December of last year, we have witnessed just such a change in market leadership. Have the winds shifted direction again for a long period of outperformance for our style of investing? The answer is unknown in the short run, but what we do believe is that disciplined investing in high-quality small- and mid-cap equities has outperformed over the long run.

### BAIRD SMALL/MID VALUE PORTFOLIO

The Baird Small/Mid Value Portfolio outperformed its benchmark for the quarter delivering a total return of 2.9% versus 1.6% for the Russell 2500 Value.

Both strong security selection and attractive sector allocation contributed to outperformance for the three-month period. Security selection bested the benchmark for eight of eleven economic sectors. In particular, information technology holdings in semiconductor-related stocks posted solid gains on improving end markets. We are optimistic about a handful of content providers for mobile devices that should benefit from the next upgrade cycle for smart phones. Real estate investment trusts also performed very well and benefited from the return to favor of yield-oriented investments. Two new holdings in the industrial sector, Orbital ATK and Quanta Services, were standouts in the sector where we outperformed. Our lack of exposure to energy-related stocks was also noteworthy; as we completely avoided the -9% returns in the sector which gave back nearly half of the gains clocked post the election.

A couple of our financial holdings were responsible for negatively impacting performance during the period. Meta Financial and Atlas Financial Holdings reported earnings below consensus. In both cases, we still see a strong core business and the extraordinary causes for the earnings misses should not impair profitability going forward. B&G Foods also pulled back on lackluster sales due to intense competition in the frozen food category. Our lack of exposure to materials was a small negative for the three-months.

### SMALL & SMALL/MID VALUE EQUITY INVESTMENT TEAM

#### MICHELLE STEVENS, CFA

Senior Portfolio Manager

#### RICHARD ROESCH, CFA

Senior Research Analyst

#### JONATHAN DEMOSS, CFA, CPA, CFP

Senior Research Analyst

#### ROB ZWIEBEL

Portfolio Specialist & Consultant Relations

#### JESSE PARSONS

Trading & Operations Analyst

### PHILOSOPHY & PROCESS

- The portfolio is rooted in the belief that value and growth investing are not mutually exclusive.
- Emphasis on companies likely to exceed "street" expectations but trade at a discount to our in house calculations of fair value.

### PORTFOLIO CONSTRUCTION

- Concentrated portfolio of generally 40-50 stocks
- Top holdings generally limited to 5% at cost, 8% at market
- Sectors capped at 30% excluding financials
- Buy and hold approach

During the quarter, we made new investments in three technology-related securities. We see Skyworks, an RF chip producer, as poised to experience a reacceleration in growth and a revaluation higher. Cyrus One, an operator of data center properties for enterprises, offers both an attractive yield and the opportunity to participate in the growing secular trend toward cloud services. Finally, we added to Cypress Semiconductor on the heels of strong operating improvements. Outside of technology, a new position was established in Rockwell Collins given its leverage to higher defense spending, the commercial aerospace cycle and synergies from their recent acquisition of BE Aerospace. To make room for these attractive investment opportunities we sold Dollar Tree, Mid-America Apartments and CMS Energy, all three long time winners in the portfolio.

## **BAIRD SMALL CAP VALUE PORTFOLIO**

The Baird Small Cap Value Portfolio outperformed its benchmark for the quarter delivering a total return of 0.9% versus -0.1% for the Russell 2000 Value.

Both strong security selection and attractive sector allocation contributed to outperformance for the three-month period. Security selection bested the benchmark for the majority of economic sectors. In particular, real estate investment trusts also performed very well and benefited from the return to favor of yield-oriented investments. Sometimes it's what you don't own, and our lack of exposure to energy-related stocks allowed us to avoid the -13% return in the sector as oil retreated. In terms of individual holdings, two chip stocks, Silicon Motion Technology and Cypress Semiconductor, posted solid gains on improving end markets. We are optimistic about a handful of content providers for mobile devices that should benefit from the next upgrade cycle for smart phones. Motorcar Parts stood out as a winner for the quarter on strong execution, as well as Lamb Weston Holdings, a new position last quarter. Two new positions, Orbital ATK and Quanta Services, added meaningfully in the industrial sector where we outperformed.

A couple of our financial holdings were responsible for negatively impacting performance during the period. Meta Financial and Atlas Financial Holdings reported earnings below consensus. In both cases, we still see a strong core business and the extraordinary causes for the earnings misses should not impair profitability going forward. B&G Foods and Orchid Paper Products also pulled back on lackluster results due to intense competition in their consumer product categories.

During the quarter, we made new investments in two technology-related securities Cyrus One, an operator of data center properties for enterprises, which offers both an attractive yield and the opportunity to participate in the growing secular trend toward cloud services. In addition, we added to Cypress Semiconductor on the heels of strong operating improvements. Outside of technology, a new position was established in NMI Holdings, a mortgage insurer formed in 2011, armed to gain market share with a strong capital structure and lack of legacy credit losses. To make room for these attractive investment opportunities we sold Omega Healthcare Investors.

Thank you for your continued support and partnership. As always, we welcome the opportunity to discuss further should you desire.

Michelle E. Stevens, CFA  
Portfolio Manager

---

### **Quarterly Conference Call**

**April 20 at 2:00 pm ET. If you would like additional details on the portfolio or the conference call, please call (800) 792-4011.**

---

| Top 5 Small/Mid Value Portfolio Contributors |             |              | Bottom 5 Small/Mid Value Portfolio Contributors |             |              |
|--|-------------|--------------|---|-------------|--------------|
| Security                                     | Avg. Weight | Contribution | Security  | Avg. Weight | Contribution |
| Cypress Semiconductor                        | 2.32        | 0.42         | Meta Financial                                  | 5.11        | -0.83        |
| Verisign                                     | 3.03        | 0.41         | Atlas Financial                                 | 1.97        | -0.55        |
| Avangrid                                     | 2.47        | 0.33         | B&G Foods                                       | 3.32        | -0.22        |
| Motorcar Parts of America                    | 2.27        | 0.31         | Hilltop Holdings                                | 2.15        | -0.18        |
| Silicon Motion Technology                    | 2.91        | 0.31         | Renasant Corporation                            | 2.72        | -0.16        |

| Top 5 Small Cap Value Portfolio Contributors |             |              | Bottom 5 Small Cap Value Portfolio Contributors |             |              |
|--|-------------|--------------|---|-------------|--------------|
| Security                                     | Avg. Weight | Contribution | Security  | Avg. Weight | Contribution |
| Cypress Semiconductor                        | 2.32        | 0.42         | Meta Financial                                  | 4.89        | -0.77        |
| Motorcar Parts of America                    | 2.70        | 0.37         | Atlas Financial                                 | 2.65        | -0.74        |
| Silicon Motion Technology                    | 2.79        | 0.30         | Bank of Internet Holdings                       | 3.04        | -0.25        |
| Lamb Weston Holdings                         | 2.30        | 0.26         | B&G Foods                                       | 3.21        | -0.22        |
| Orbital ATK                                  | 2.14        | 0.25         | Patrick Industries                              | 2.76        | -0.20        |

The Baird Equity Asset Management Small & Small/Mid Value Equity commentary is incomplete if not accompanied with the most recent performance report.

The Russell 2500 Value Index measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2500 Index companies with lower price-to-book ratios and lower forecasted growth values. The Russell Indices are a trademark of the Frank Russell Company. The Russell 2000 Value Index measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values. The Russell Indices are a trademark of the Frank Russell Company.

Indices are unmanaged and direct investment is not possible. Past performance is no guarantee of future results.

| Investment Professional   | Years of Experience | Years with Baird | Educational Background   |
|---|---------------------|------------------|--|
| <b>Michelle Stevens, CFA</b><br>Senior Portfolio Manager          | 24                  | 5                | MBA – (University of Cincinnati)<br>BS – Economics (Wittenberg University)         |
| <b>Richard Roesch, CFA</b><br>Senior Research Analyst             | 24                  | 5                | BS – Finance (Butler University)   |
| <b>Jonathan DeMoss, CFA, CPA, CFP</b><br>Senior Research Analyst  | 21                  | 5                | MBA – (Indiana University)<br>BS – Accounting & Management (Iowa State University) |
| <b>Rob Zwiebel</b><br>Portfolio Specialist & Consultant Relations | 26                  | 5                | BS – Finance (University of Dayton)  |
| <b>Jesse Parsons</b><br>Trading & Operations Analyst              | 12                  | 5                | BBA – Finance & Marketing (University of Kentucky)                                 |