

MARKET REVIEW

The second quarter of 2018 produced more rewarding absolute results than the first quarter, yet relative returns vexed active managers. Only 12% of small cap value managers and 16% of SMID value managers outperformed their benchmark for the period. Small Cap ETF flows were off the charts and this drove outsized returns for the low end of the under-owned market cap range where liquidity is scarce. Across all market cap segments, any kind of valuation discipline hurt relative performance. Uncharacteristically, companies that beat earnings in the first quarter were generally not rewarded, trailing historical post earnings surprise returns by over 300 basis points. Most of the underperformance occurred early in the quarter, however, and June saw a rotation back towards quality and value. The same held true for the Baird Small/Mid and Small Value Portfolios which underperformed in April, but posted better returns the remainder of the quarter.

High P/E Stocks and Companies with No Earnings were Big Winners in Q2 2018¹

Price/Earnings Ratio Quintile	Russell 2000 Value (% total return)	Russell 2500 Value (% total return)
Q1 (Lowest)	4.4	-2.0
Q2	4.9	-0.8
Q3	8.2	0.8
Q4	8.4	4.8
Q5	12.0	8.5
Non-earners	14.3	20.5

BAIRD SMALL/MID VALUE PORTFOLIO

For the quarter, the Baird Small/Mid Value Portfolio delivered a total return of 2.6% versus 5.8% for the Russell 2500 Value. For the last twelve months, the Portfolio gained 16.5%, outpacing the benchmark return of 11.5%. Further, the Portfolio has outperformed the Russell 2500 Value over nearly every trailing time period and delivered an average annual return since inception of 12.0% (January-2000) versus 10.2% for the benchmark.

Highlights in terms of positive absolute returns that bested the benchmark include gains from the Portfolio's holdings in Healthcare, Consumer Discretionary, Information Technology and Real Estate. Zagg was the single largest contributor, soaring over 40%, and we benefitted from adding to the position on weakness after the first quarter of the year. The portfolio remains overweight healthcare and ICU Medical again helped fuel outperformance for the period. Stamps.com was also a standout in terms of individual stock performance.

In terms of relative performance for the three-months, two sectors were primarily responsible for trailing the benchmark: Energy and Financials. Within Energy, our single holding, Solaris, pulled back on concerns of a drilling slowdown in the Permian Basin due to takeaway bottleneck issues. We acknowledge such concerns, but expect the company's diversification and growing market share combined with high oil prices to support strong earnings growth over the next year. Within Financials, Meta Financial was

SMALL & SMALL/MID VALUE EQUITY INVESTMENT TEAM

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ROB ZWIEBEL

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JESSE PARSONS

Trading & Operations Analyst

PHILOSOPHY & PROCESS

- The portfolio is grounded 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 calculation of fair value.

PORTFOLIO CONSTRUCTION

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

weak due to growing pains as expenses related to recent acquisitions have clipped near-term earnings. The company has been a strong performer since purchase, and we expect the long-term value of these growth initiatives to be reflected in a higher stock price over the coming years. Finally, the Portfolio's largest position, Boingo Wireless, pulled back 8% despite issuing better than expected earnings and guidance.

During the quarter, we initiated positions in three new holdings: Air Lease, Sunstone Hotel Investors and Resonant. We also added to positions in Zagg, Jazz Pharmaceuticals and Ryman Hospitality. We sold Atlas Financial and trimmed NMI Holdings to fund new purchases.

BAIRD SMALL VALUE PORTFOLIO

For the quarter, the Baird Small Value Portfolio delivered a total return of 5.0% versus 8.3% for the Russell 2000 Value. For the last twelve months, the Portfolio returned 17.3% outpacing the benchmark return of 13.1%. Furthermore, the Portfolio has outperformed the Russell 2000 Value since inception (March 2005), posting an average annual return of 9.8% versus 7.9% for the benchmark.

Highlights in terms of positive absolute returns that bested the benchmark include gains from the Portfolio's holdings in Information Technology, Healthcare, Consumer Discretionary, and Real Estate. Zagg was the single largest contributor, soaring over 40%, and we benefitted from adding to the position on weakness after the first quarter of the year. New purchase, Immersion Technology, also added meaningfully to the quarter's return. The portfolio remains overweight healthcare and ICU Medical again helped fuel outperformance for the period. Merchants Bancorp was also a standout in terms of individual stock performance.

In terms of relative performance for the three-months, two sectors were primarily responsible for trailing the benchmark: Energy and Financials. Within Energy, Solaris pulled back on concerns of a drilling slowdown in the Permian Basin due to takeaway bottleneck issues. We acknowledge such concerns but expect the company's diversification and growing market share combined with high oil prices to support strong earnings growth over the next year. Within Financials, Meta Financial was weak due to growing pains as expenses related to recent acquisitions have clipped near-term earnings. The company has been a strong performer since purchase, and we expect the long-term value of these growth initiatives to be reflected in a higher stock price over the coming years. Finally, the Portfolio's largest position, Boingo Wireless, pulled back 8% despite posting better than expecting earnings and guiding higher during the period.

During the quarter, we initiated positions in three new holdings: Air Lease, Sunstone Hotel Investors and Resonant. We also added to positions in Zagg and Ryman Hospitality. We both added to our Immersion Corp. and then trimmed it following a quick 40% gain. To fund new purchases, we sold Atlas Financial, LCI Industries and Connecticut Water Services.

Generally, we remain pleased with the earnings power of the portfolio and despite not keeping pace with the benchmark in April, we expect valuations and earnings growth expectations to support competitive returns over the near term.

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

¹Source: Jefferies via Factset

Top 5 Small/Mid Value Portfolio Contributors			Bottom 5 Small/Mid Value Portfolio Contributors		
Security	Avg. Weight	Contribution	Security	Avg. Weight	Contribution
ZAGG INC	2.91	0.98	BOINGO WIRELESS	5.65	-0.59
STAMPS.COM	3.95	0.91	META FINANCIAL	4.08	-0.46
ICU MEDICAL	4.37	0.68	ORCHIDS PAPER PRODUCTS	0.51	-0.39
LAMB WESTON	2.59	0.42	LKQ CORPORATION	1.82	-0.35
ATLAS AIR WORLDWIDE	2.24	0.39	ESSENT GROUP	1.56	-0.30

Top 5 Small Cap Value Portfolio Contributors			Bottom 5 Small Cap Value Portfolio Contributors		
Security	Avg. Weight	Contribution	Security	Avg. Weight	Contribution
ZAGG INC	2.91	0.98	BOINGO WIRELESS	5.64	-0.62
STAMPS.COM	3.92	0.93	META FINANCIAL	4.02	-0.45
ICU MEDICAL	5.65	0.89	ORCHIDS PAPER PRODUCTS	0.49	-0.38
MERCHANTS BANCORP	2.49	0.74	LCI INDUSTRIES	1.23	-0.34
IMMERSION CORPORATION	2.09	0.68	SOLARIS OILFIELD	2.39	-0.30

The Baird Equity Asset Management Small & Small/Mid Value Equity commentary is incomplete if not accompanied with the most recent performance report. Performance for the Small & Small/Mid Value Strategies can be found on our website BairdEquityAssetManagement.com, or by clicking on the following links: [Small Cap Value Strategy](#) & [Small/Mid Cap Value Strategy](#).

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.

As of 06/30/18, the top ten holdings for the Baird Small/MidCap Value Strategy were: Boingo Wireless 5.5%; ICU Medical 4.7%; Stamps.com 4.1%; Zagg 3.9%; Bofl Holding 3.7%; American Financial Group 3.2%; Meta Financial 3.2%; Silicon Motion 3.0%; Cypress Semiconductor 2.9%; and Lamb Weston 2.7%.

As of 06/30/18, the top ten holdings for the Baird Small Cap Value Strategy were: ICU Medical 6.0%; Boingo Wireless 5.5%; Stamps.com 4.1%; Zagg 3.8%; Bofl Holding 3.5%; Lamb Weston 3.3%; J2 Global 3.2%; NMI Holdings 3.1%; Meta Financial 3.1%; and Merchants Bancorp 2.9%.

The performance of any single portfolio holding is no indication of the performance of other portfolio holdings of the Baird Small Cap Value Strategy or Baird Small/Mid Cap Value Strategy. Past performance is no guarantee of future results.

Investment Professional	Years of Experience	Years with Baird	Educational Background
Michelle Stevens, CFA Senior Portfolio Manager	25	6	MBA – (University of Cincinnati) BS – Economics (Wittenberg University)
Richard Roesch, CFA Senior Research Analyst	25	6	BS – Finance (Butler University)
Jonathan DeMoss, CFA, CPA, CFP Senior Research Analyst	22	6	MBA – (Indiana University) BS – Accounting & Management (Iowa State University)
Rob Zwiebel Portfolio Specialist & Consultant Relations	27	6	BS – Finance (University of Dayton)
Jesse Parsons Trading & Operations Analyst	13	6	BBA – Finance & Marketing (University of Kentucky)