

### MARKET UPDATE

The economic recovery continued but not without its challenges as supply chains across many industries struggled to meet demand. In addition, equity markets absorbed an increasingly mixed message from Federal Reserve officials regarding the confluence of rising inflation and interest rate policy. Worry over higher inflation entered the picture in the first quarter and continued through the second as data confirmed higher levels of price increases than experienced for some time. However, the significant and stimulus-enhanced spending power of businesses and individuals along with a 10-year treasury rate that moved surprisingly lower during the quarter provided fuel for strong equity gains.

The Russell 2500 Growth Index, our target benchmark for our Small/Mid Cap Growth Strategy, continued to move higher through June 30, 2021, though it remained a volatile ride. Growth stocks began to rally starting mid-May and the Russell 2500 Growth benchmark return exceeded the Russell 2500 Value return for the second quarter. Both of these “smid” benchmarks performed better than the Russell 2000 Growth and Value benchmarks, and all small and smid benchmarks trailed the over 8% return of the SPX index.

### PORTFOLIO COMMENTARY

The Baird Small/Mid Cap Growth Strategy returned 8.4%, gross of fees, in the second quarter of 2021, generating 240 basis points of relative outperformance versus the Russell 2500 Growth benchmark return of 6.0%. Overall, we were pleased with the Strategy performance, with strong results from several individual holdings. Relative performance was strongest in April, and then was slightly negative in May in June. Based on absolute returns, the technology sector was by far the best performer in the quarter, up over 11% as growth stocks rallied hard from mid-May until quarter end. The three strongest sectors for the portfolio were real estate, healthcare, and consumer discretionary. Regarding relative performance, the strongest sectors for the portfolio were healthcare, industrials, and consumer discretionary. Sectors that detracted from relative performance were telecom, financials, and technology.

Similar to the first quarter, healthcare was our strongest relative performing sector. Our underweight of speculative, unprofitable biotech stocks benefited the portfolio’s performance in the quarter. Healthcare stocks continue to trade on expectations for surgical volumes relative to Covid trends. While there is clearly improvement in volumes due to increasing rates of vaccinations, that is not the case in all states, or in all countries. Our highest growth holdings performed incredibly strong in the second quarter, especially as the market rallied from mid-May. We had four holdings return greater than 40% in the quarter: Shockwave, Novocure, Staar Surgical, and Avid Bioservices. We trimmed our position in Shockwave and sold Novocure completely, as the company approached our market cap maximum and exited the R2500G benchmark after reconstitution at the end of June. Slight relative detractors in the quarter were smaller cap positions Heron Therapeutics and Innovage. We also trimmed another high growth holding in the quarter, Inspire Medical.

The portfolio also generated positive relative returns in industrials. Based on the recent Russell reclassification of sectors and industry groups, the industrials industry classification is extremely broad in our view, as it includes companies we would classify as financials, business services, and even high multiple software-as-a-service companies. Similar to the first quarter, two of our three strongest stocks were Generac and MasTec. Similar to Novocure, Generac was sold as the stock is too big for “Smid” and is no longer in the R2500g benchmark. We also had good performance from long-time holding Trex and newer position Kornit Digital. Both companies reported strong quarterly results that resulted in stock price appreciation. Industrial holdings that detracted from second quarter performance included names that are more cyclical (Littlefuse and Wiscott Mobile Mini) or exposed to the Covid “re-opening” trade that has faltered recently

### TENURED SMALL/MID CAP GROWTH INVESTMENT TEAM

#### JONATHAN GOOD

Portfolio Manager

#### KEN HEMAUER, CFA

Senior Research Analyst

#### CORBIN WEYER, CFA, CPA

Director of Research & Senior Research Analyst

#### DOUGLAS GUFFY

Senior Research Analyst

#### KARAN SABERWAL

Senior Research Analyst

#### JOSH HEINEN

Research Analyst

#### CHUCK SEVERSON, CFA

Mid Cap Growth Senior PM

- Team members have equity ownership in Baird\*
- Deep sector expertise
- Average years of experience: 19 years

*\*All eligible team members (six) are Baird stock owners.*

(Euronet). We continue to like the long-term prospect for Euronet, but European travel has not accelerated as quickly as we thought given Covid trends.

In contrast to the first quarter, relative performance was strong in consumer discretionary during the second quarter. Strength was broad-based across several holdings, many of which reported strong quarterly results, including Pool Corp, Crocs, Deckers, and Etsy. Given the large increase in market capitalization in Etsy and Burlington, we sold our positions, as the companies are no longer in the R2500G benchmark. Detractors in the quarter included SiteOne, Williams Sonoma, and Under Armour. We decided to exit Under Armour as our conviction in the brand strength and ultimately revenue momentum waned. We remain overweight the consumer discretionary sector, though the magnitude of the overweight has decreased slightly after the Russell reconstitution, which added weight to the sector.

Three sectors generated negative relative performance in the quarter: telecom, financial services, and technology. Telecom and financials are small sectors in our benchmark, and relative performance was only down slightly. Technology, by weight, is the second largest sector in the Russell 2500 Growth benchmark. In short, though our tech holdings returned more than the overall benchmark return for the quarter, they lagged the 11% return of the technology sector. Even after adding a few new high growth ideas during the quarter, we simply did not own enough of the higher growth, high multiple software stocks that rallied hard in early May. We exited positions in Bandwidth and Qualys during the quarter and added new positions in Qualtrics and Five9.

## **OUTLOOK**

With fiscal and monetary stimulus still flowing and unmet demand across so many industries, the underpinnings are in place for strong economic performance in the second half of the year. The key for markets will be the sustainability of the strength and how much translates into earnings. The breadth of demand strength bodes well for company revenue growth, and near-term pricing power should protect margins, adding up to a favorable earnings picture. The pick-up in inflation and the debate on the path of rates complicates things, but recoveries and markets rarely move in straight lines. We are mindful of the strong returns off the March 2020 low and the elevated valuations in parts of the equity market. It is these things that bring us back to the importance of broad diversification and the fundamental importance of strong balance sheets and profitability of the companies we own.

We remain fully invested in what we view are high-quality growth stocks and believe our portfolio is sufficiently diversified across higher growth secular stories, businesses that can compound earnings growth for several years, as well as having some select cyclical exposure.

On behalf of the entire team at Baird Equity Asset Management, we thank you for your support of our Small/Mid Cap Growth Strategy.

## Small/Mid Cap Growth Investment Team

Investment Professional	Years of Experience	Years with Baird	Coverage Responsibility	Educational Background
<b>Jonathan Good</b> Portfolio Manager	21	15	Healthcare	MBA – (Northwestern University – Kellogg) BS – Applied and Biomedical Sciences (Pennsylvania)
<b>Ken Hemauer, CFA</b> Senior Research Analyst	27	27	Financial Services	MS – Finance - The Applied Security Analysis Program (University of Wisconsin – Madison) BBA – Finance (UW–Madison)
<b>Corbin Weyer, CFA, CPA</b> Director of Research & Senior Research Analyst	11	11	Consumer Discretionary & Staples	BSBA – Finance & Accounting (Marquette University)
<b>Doug Guffy</b> Senior Research Analyst	37	17	Energy, Industrials & Materials	MBA – Finance (Ball State University) BA – Economics & Government (Anderson University)
<b>Karan Saberwal</b> Senior Research Analyst	5	2	Information Technology	MBA (Northwestern University – Kellogg) BE – Bachelor of Engineering (Army Institute of Technology, University of Pune)
<b>Josh Heinen</b> Research Analyst	<1	<1	Generalist	MS – Finance - The Applied Security Analysis Program (University of Wisconsin – Madison) BBA – Finance (UW–Madison)
<b>Chuck Severson, CFA</b> Mid Cap Growth PM	34	34	Generalist	MS – Finance - The Applied Security Analysis Program (University of Wisconsin – Madison) BBA – Accounting and Finance (UW–Madison)

## Small/Mid Cap Growth Top & Bottom Contributors

Top 5 Portfolio Contributors			Bottom 5 Portfolio Contributors		
Security	Avg. Weight	Contribution	Security	Avg. Weight	Contribution
Pool Corporation (POOL)	2.77	0.76	Inspire Medical Systems, Inc. (INSP)	1.56	-0.21
NovoCure Ltd. (NVCR)	0.69	0.67	Williams-Sonoma, Inc. (WSM)	1.04	-0.18
Generac Holdings Inc. (GNRC)	2.51	0.57	Upland Software, Inc. (UPLD)	1.22	-0.18
Shockwave Medical, Inc. (SWAV)	1.49	0.55	Bandwidth Inc. Class A (BAND)	0.49	-0.15
Crocs, Inc. (CROX)	1.27	0.52	Under Armour, Inc. Class A (UAA)	1.75	-0.11

## Small/Mid Cap Growth Average Annual Returns (%)\*

	QTD <sup>1</sup>	YTD <sup>1</sup>	1 Year	3 Years	5 Years	Since Inception (9/30/15)
Composite – Gross	8.42	11.96	49.52	25.01	25.46	22.82
Composite – Net	8.20	11.50	48.28	23.93	24.45	21.82
Russell 2500 Growth Index	6.04	8.67	49.63	20.15	20.68	18.90

\* 06/30/2021 composite returns are preliminary.

<sup>1</sup> Returns for periods of less than one year are not annualized.

Positions identified above do not represent all the securities held, purchased or sold during this time period. The contribution to return of these securities is calculated by multiplying the weight of the security at the beginning of the time period by the security return and represents a model portfolio. To obtain a complete list of positions and contributions for the period, please contact Baird Equity Asset Management at 800-792-4011. Past performance does not guarantee future results.

Returns are presented gross and net of management fees and include the reinvestment of all income. Composite performance is presented gross of foreign withholding taxes on dividends, interest income, and capital gains.

The Russell 2500<sup>®</sup> Growth Index measures the performance of those Russell 2500 companies with above average price-to-book ratios and higher forecasted growth values. When sorted by market cap, the Russell 2500<sup>®</sup> Index consists of all of the companies in the Russell 3000<sup>®</sup> Index, except for the 500 largest companies by market capitalization in that index. 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.

This commentary represents portfolio management views and portfolio holdings as of 6/30/21. Those views and portfolio holdings are subject to change without notice. The specific securities identified do not represent all the securities purchased, sold or held for accounts and you should not assume these securities were or will be profitable. No public market exists for stock of Baird Financial Group.

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