

BACK TO SCHOOL

As if a bell rang, small and mid-cap stocks sprung to life in September to post strong returns for the month and saving the third quarter of 2017 from negative territory. The renewed hopes for tax reform sparked the rally in the smaller indices which had traded mostly lower over the summer. Despite the recent spurt higher, however, large cap and growth indices remain ahead of small cap and value indices so far this year.

On the heels of the most recent run, market commentary has increasingly focused on valuations which admittedly look rich versus history, especially since earnings growth has rolled over again this quarter for the Russell 2000. That means higher stock prices are being driven by higher multiples, an unsustainable trend. To support a meaningful advance from here, we would look for help from lower corporate tax rates and the re-emergence of earnings growth.

On a positive note, quality stocks continue to trade at significant discounts to historical valuations. As measured by price-to-sales and price-to-book, the highest return on equity (ROE) companies in our benchmark trade at roughly half the relative valuation of the lowest return on equity companies. That's good news for our portfolios which are packed with high quality businesses in the top quintile of profitability as measured by ROE...40% of holdings or twice the benchmark. That's not a coincidence, but instead a by-product of our process, which seeks to identify superior companies which are temporarily under-appreciated by the market.

BAIRD SMALL/MID VALUE PORTFOLIO

The Baird Small/Mid Value Portfolio meaningfully outperformed its benchmark for the quarter delivering a total return of 8.3% versus 3.8% for the Russell 2500 Value. For the year, the portfolio has returned 15.3% outpacing the benchmark return of 5.8%. Further, the portfolio has outperformed the Russell 2500 Value over nearly every trailing time period and delivered an average annual return since inception of 12.1% (January-2000) versus 10.2% for the benchmark.

The Portfolio benefited from strong security selection across most economic sectors. As discussed in prior quarters, our barbell positioning in terms of beta served the portfolio well during both up and down market days. With the exception of September, where the market experienced a brief resurgence of the Trump trade, companies with superior earnings growth profiles were rewarded along with those exhibiting defensive characteristics. Top performing sectors included Consumer Discretionary, Telecommunications, Industrials, and Information Technology. Several individual holdings advanced on strong earnings and guidance including Boingo Wireless, Stamps.com, Zagg Inc, and Atlas Financial. Additionally, both Rockwell Collins and Orbital ATK were acquired during the quarter propelling their stocks higher.

For the three-month period, detractors included Financials and Real Estate, primarily due to the upward move in rates during September which favored yield-sensitive banks,

SMALL & SMALL/MID VALUE EQUITY INVESTMENT TEAM

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INVESTMENT PROCESS

Emphasis on companies likely to exceed "street" expectations but trades at a discount to our in house calculations of fair value.

PORTFOLIO CONSTRUCTION

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

where we are under-represented over dividend payers. Physicians Realty Trust, Meta Financial and J2 Global were top among underperformers.

During the quarter, we replaced Avangrid in the utility space with Algonquin Power & Utilities which offers an attractive play on utility-related infrastructure investments with an enviable 15% growth outlook. On the heels of Orbital ATK being acquired we exited the position deploying the cash to purchase Atlas Air Worldwide, a direct benefactor of continued growth in the e-commerce space. We also initiated a position in two new technology companies, Dolby Laboratories and Integrated Device Technology. Lastly, we sold Renasant and trimmed our position in Verisign, a long-time winner 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 8.4% versus 5.1% for the Russell 2000 Value. Year-to-date the portfolio has returned 12.6% outpacing the benchmark return of 5.7%.

The portfolio benefited from strong security selection across most economic sectors. As discussed in prior quarters, our barbell positioning in terms of beta served the portfolio well during both up and down market days. With the exception of September, where the market experienced a brief resurgence of the Trump trade, companies with superior earnings growth profiles were rewarded along with those exhibiting defensive characteristics. Top performing sectors included Consumer Discretionary, Telecommunications, and Industrials. Several individual holdings advanced on strong earnings and guidance including Boingo Wireless, Stamps.com, Zagg Inc, and Atlas Financial. Additionally, Orbital ATK was acquired during the quarter propelling its stock higher.

For the three-month period, detractors included Financials and Real Estate, primarily due to the upward move in rates during September which favored yield-sensitive banks, where we are under-represented over dividend payers. Physicians Realty Trust, Meta Financial, J2 Global and Eagle Pharmaceutical were top among underperformers.

On the heels of Orbital ATK being acquired we exited the position deploying the cash to purchase Atlas Air Worldwide, a direct benefactor of continued growth in the e-commerce space. We also initiated a position Integrated Device Technology, a semiconductor company offering low power, high performance chips to the computing and telecommunications markets. Finally, we exited our position in Renasant Corporation, a long-time winner in the Portfolio.

The Baird Value Team's strategy is to invest in companies with catalysts that we believe will lead to both strong absolute return and market outperformance over a market cycle. Even in a market with rising valuations, we find our strategy effective at identifying opportunities to earn attractive returns for investors thanks to market inefficiencies and human nature.

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

Top 5 Small/Mid Value Portfolio Contributors			Bottom 5 Small/Mid Value Portfolio Contributors		
Security	Avg. Weight	Contribution	Security	Avg. Weight	Contribution
Zagg Inc	2.78	1.88	Meta Financial	3.96	-0.61
Boingo Wireless	5.01	1.87	J2 Global	2.69	-0.39
Stamps.com	3.34	0.94	Physicians Realty Trust	2.66	-0.37
Orbital ATK	2.18	0.75	Renasant Corporation	1.96	-0.36
Rockwell Collins	2.28	0.53	LTC Properties	2.58	-0.21

Top 5 Small Cap Value Portfolio Contributors			Bottom 5 Small Cap Value Portfolio Contributors		
Security	Avg. Weight	Contribution	Security	Avg. Weight	Contribution
Zagg Inc	3.99	2.73	Meta Financial Group	3.89	-0.62
Boingo Wireless	5.07	1.94	Eagle Pharmaceuticals	1.53	-0.54
Stamps.com	3.36	0.97	J2 Global	2.89	-0.44
Orbital ATK	2.26	0.79	Renasant Corporation	2.31	-0.38
Atlas Financial	2.62	0.67	Physicians Realty Trust	2.59	-0.36

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
Michelle Stevens, CFA Senior Portfolio Manager	24	5	MBA – (University of Cincinnati) BS – Economics (Wittenberg University)
Richard Roesch, CFA Senior Research Analyst	24	5	BS – Finance (Butler University)
Jonathan DeMoss, CFA, CPA, CFP Senior Research Analyst	21	5	MBA – (Indiana University) BS – Accounting & Management (Iowa State University)
Rob Zwiebel Portfolio Specialist & Consultant Relations	26	5	BS – Finance (University of Dayton)
Jesse Parsons Trading & Operations Analyst	12	5	BBA – Finance & Marketing (University of Kentucky)