

### TWO STEPS FORWARD, TWO STEPS BACK

Despite a couple of quarters of double-digit returns (positive and negative) over the past year, the S&P 500 and Dow Jones Industrial Average have made little price progress. During this same time, the Federal Reserve has raised the federal funds interest rate twice (Sep/Dec 2018) and cut rates twice (Jul/Sep 2019). Under the surface, however, forward economic growth and corporate profit expectations have reset more dramatically. The net effect being the U.S. ten year bond yield down nearly 160 basis points and small company stocks, as measured by the Russell 2000, down over 10% during the trailing year.

This quarter delivered ho-hum returns, as well, but there was a lot of volatility generated by positioning around a number of high-profile themes. This was particularly the case for US-China trade. The Fed's pivot to accommodative monetary policy with two rate cuts helped counter trade uncertainty but was offset by further weakness in manufacturing and trade. Oil prices and value stocks gave market participants head fakes, popping in September only to resume their downward trends by quarter-end. There was also some debate about the yield curve inversion and its power to forecast recession. While S&P 500 earnings are on track to decline in the third quarter of 2019, there continues to be expectations for a return to double digit growth in 2020.

Weaker earnings and much lower interest rates play to the positioning of our Small and SMID Value Portfolios. We do not believe the slowdown in the U.S. economy has run its course. Weak manufacturing will likely be reflected in weaker than forecasted corporate profits and an earnings recession may still lie ahead. In this environment it's critically important to focus on earnings quality and stability alongside valuations. In addition, yield-oriented equities look increasingly attractive as bond yields have plummeted.

And what about small cap stocks in this environment? Good news, they have historically outperformed when the Federal Reserve cuts interest rates:

#### Total Return Performance Following Fed Funds Rate Cut

First 3 Months			First 6 Months			First 12 Months		
Small Caps	Mid Caps	Large Caps	Small Caps	Mid Caps	Large Caps	Small Caps	Mid Caps	Large Caps
11.0%	9.3%	5.5%	15.4%	13.6%	9.9%	27.9%	23.5%	14.7%

Average returns of 12 periods following interest rate cuts since November 1957. Source: Jefferies

### BAIRD SMALL/MID CAP VALUE

For the quarter, the Baird Small/Mid Value portfolio marginally underperformed the benchmark Russell 2500 Value with a gross return of -0.25% versus 0.13% for the benchmark. The portfolio has delivered investors a solid long-term absolute return of 11.0% since inception (January 2000) including outperforming the benchmark over the trailing 3-yr, 7-yr, 10-yr, 15-yr, and since inception time periods gross of fees.

#### 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 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

Performance for the quarter was aided by solid results from our holdings in Real Estate Investment Trusts, Financials, Utilities, Consumer Staples, and Consumer Discretionary. Additionally, our lack of exposure to Energy contributed positively as it was once again the worst performing sector in the benchmark despite a temporary spike in oil prices from the drone attack in Saudi Arabia. Individual holdings which outperformed include CyrusOne, Agree Realty, Meta Financial Group, Algonquin Power and Utilities, Lamb Weston, and LKQ. Holding back returns for the quarter were certain positions in Information Technology, Health Care, Communication Services, and Industrials including ICUI Medical, Zagg, Boingo Wireless, Silicon Motion and Atlas Air.

We took advantage of volatility during the quarter to initiate positions in Astronics, Essential Properties Realty Trust, Fidelity National Financial, and CACI International and VICI Properties. To make room for these new additions we exited Silicon Motion, Atlas Air, and Jazz Pharmaceuticals in each case where we believed the potential for negative earnings revisions had increased substantially. We also sold Pinnacle West which reached our price objective.

### **BAIRD SMALL CAP VALUE**

For the quarter, the Baird Small Value portfolio outperformed the benchmark Russell 2000 Value with a gross return of -0.3% versus -0.6% for the benchmark. In addition to long-term outperformance since inception (March-2005), the portfolio has outperformed the benchmark over the trailing 1-yr, 2-yr, and 3-yr time periods gross of fees.

Performance for the quarter was aided by solid results from our holdings in Real Estate Investment Trusts, Financials, Utilities, and Consumer Staples. Additionally, our lack of exposure to Energy contributed positively as it was once again the worst performing sector in the benchmark despite a temporary spike in oil prices from the drone attack in Saudi Arabia. Individual holdings contributing to second quarter's outperformance include CyrusOne, Essential Properties Realty Trust, Meta Financial Group, Algonquin Power & Utilities, and Lamb Weston. Holding back returns for the quarter were certain positions in Consumer Discretionary, Information Technology, Health Care, and Communication Services including ICUI Medical, Zagg, Boingo Wireless, Silicon Motion and Atlas Air.

During the quarter we initiated new positions in Astronics, Construction Partners, Preferred Bank, First American Financial, and Perspecta. To make room for these new additions we exited Silicon Motion, Atlas Air, and LTC Properties all due to concerns regarding future earnings expectations. We also trimmed our position in Algonquin Power & Utilities, a long-time winner in the portfolio.

For more details regarding attribution and our current positioning, please dial in to our quarterly call on October 24, 2019 at 2:00 PM EST. Thank you for your continued support and partnership.

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
CyrusOne	2.90	0.98	Boingo Wireless	3.07	-1.49
Agree Realty Corp	3.23	0.51	ICU Medical	2.97	-1.44
Meta Financial	3.06	0.48	Atlas Air Worldwide	0.88	-0.69
Lamb Weston	2.80	0.39	Astronics	0.84	-0.36
Algonquin Power & Utilities	2.78	0.38	Silicon Motion Tech	0.83	-0.36

Top 5 Small Cap Value Portfolio Contributors			Bottom 5 Small Cap Value Portfolio Contributors		
Security	Avg. Weight	Contribution	Security	Avg. Weight	Contribution
CyrusOne	2.91	0.98	ICU Medical	3.07	-1.51
CACI International	4.10	0.51	Boingo Wireless	3.05	-1.48
Lamb Weston	3.53	0.50	Atlas Air Worldwide	1.32	-1.05
Algonquin Power & Utilities	3.74	0.49	Silicon Motion Tech	1.24	-0.56
Meta Financial	3.10	0.48	Astronics	0.87	-0.37

	Baird Small/Mid Value Composite Performance							Baird Small Value Composite Performance						
	QTD	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception (1/1/00)	QTD	YTD	1-Year	3-Year	5-Year	10-Year	Since Inception (3/1/05)
GROSS OF FEES	-0.3	13.6	-7.0	7.4	6.7	11.3	11.0	-0.3	12.7	-7.4	6.9	5.9	10.3	8.5
NET OF FEES	-0.5	12.9	-7.8	6.5	5.8	10.4	10.0	-0.4	12.3	-7.8	6.4	5.3	9.6	7.7
INDEX*	0.1	15.4	-4.4	6.9	7.0	11.0	9.5	-0.6	12.8	-8.3	6.5	7.2	10.1	6.7

\* Index for the Baird Small/Mid Value Composite is the Russell 2500 Value. Index for the Baird Small Value Composite is the Russell 2000 Value.

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.

Performance for the Small & Small/Mid Value Strategies can be found on our website [BairdEquityAssetManagement.com](http://BairdEquityAssetManagement.com), or by clicking on the following links: [Small Cap Value Strategy](#) & [Small/Mid Cap Value Strategy](#).

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 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.

This commentary represents portfolio management views and portfolio holdings as of 09/30/19. 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.

Investment Professional	Years of Experience	Years with Baird	Educational Background
<b>Michelle Stevens, CFA</b> Senior Portfolio Manager	26	7	MBA – (University of Cincinnati) BS – Economics (Wittenberg University)
<b>Richard Roesch, CFA</b> Senior Research Analyst	26	7	BS – Finance (Butler University)
<b>Jonathan DeMoss, CFA, CPA, CFP</b> Senior Research Analyst	23	7	MBA – (Indiana University) BS – Accounting & Management (Iowa State University)
<b>Rob Zwiebel</b> Portfolio Specialist & Consultant Relations	28	7	BS – Finance (University of Dayton)
<b>Jesse Parsons</b> Trading & Operations Analyst	14	7	BBA – Finance & Marketing (University of Kentucky)