

MARKET REVIEW

U.S. equity markets dipped into bear market territory during the final quarter of the year. Global synchronized growth soured to global synchronized deceleration as the year progressed. That coupled with the scepter of monetary tightening, as the Federal Reserve both raised the Federal Funds rate and shrank the balance sheet, were more than bulls could bear. As we enter 2019, analysts have begun to slash corporate earnings estimates after raising them steadily most of last year. The 10.2% earnings growth projected in 2019 for the S&P 500 Index just three months ago is now estimated at 6.5%, with the threat that 1st quarter earnings reports may drive that number further south.

Guide points signal that we are in the late innings of this economic cycle which calls for more defensive posturing. As such, we have raised our exposure to Real Estate Investment Trust, Utilities, and companies with stable cash flows. It remains to be seen whether this slowdown will ultimately culminate in a recession, but the markets' behavior has begun to discount that probability.

Bear markets rarely resolve in V-shaped bottoms and we anticipate more backing and filling before moving meaningfully higher. We expect heightened volatility to continue as we begin the New Year and are on watch for opportunities to sell in to rallies and buy opportunistically on pull backs. The portfolios have historically exhibited strong capital preservation demonstrated by their low downside capture ratios. This quality was apparent during December's plunge when both Small Value and Small/Mid Value outperformed for the month by 450 and 285 basis points, respectively.

On a valuation note, the Portfolios are trading at the most compelling PEG ratios we've seen in the past decade, and our earnings estimates are holding up better than the market averages. The dividend yield on both Portfolios is 2.0% and the absolute P/E ratio on 2019 estimates is less than 14 times earnings. Low P/E stocks were underperformers in 2018, particularly the second quarter of the year, as the market disproportionately rewarded stocks already trading at lofty multiples. History would suggest that value is poised for superior returns in the near future.

BAIRD SMALL VALUE PORTFOLIO

For the quarter, the Baird Small Value Portfolio outperformed its benchmark, delivering a total gross return of -18.0% versus -18.7% for the Russell 2000 Value. For the last twelve months, the Portfolio returned -15.1% gross of fees versus the benchmark return of -12.9%. While the past two years have been challenging for value managers, the Portfolio has posted a positive annualized return of 0.7% versus a negative return of -3.1% for the Russell 2000 Value. The Portfolio has also outperformed the Russell 2000 Value since inception (March 2005), posting an average annual return of 8.0% gross of fees versus 6.1% for the benchmark.

In terms of economic sectors, Real Estate Investment Trusts and Consumer Staples were the greatest positive contributors while Financials and Consumer Discretionary were detractors. The Portfolio's underweight to energy stocks also aided performance meaningfully given the 43% plunge in the benchmark sector. Lamb Weston, Agree Realty and Algonquin Power were standout individual stock contributors for the period, all

SMALL & SMALL/MID VALUE EQUITY INVESTMENT TEAM

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ROB ZWIEBEL

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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

defensive in nature. Boingo Wireless, Zagg and Spartan held back performance for the three-month period.

During the quarter, we initiated positions in several new holding including Essent Group, National Retail Properties, Southwest Gas, CareTrust REIT, and CACI International. We also added to our positions in Air Transport Group, Physicians Realty and Stamps.com.

To fund new purchases, we sold Patrick Industries, Quanta Services, Belden, Knowles, Sunstone Hotel Investors and Diamond Hill, as well as trimmed several holdings.

BAIRD SMALL/MID VALUE PORTFOLIO

For the quarter, the Baird Small/Mid Value Portfolio delivered a total gross return of -18.2% versus -17.1% for the Russell 2500 Value. For the last twelve months, the Portfolio returned -14.5% gross of fees versus the benchmark return of -12.4%. While the past two years have been challenging for value managers, the Portfolio has posted a positive annualized return of 2.4% versus a negative return of -1.7% for the Russell 2000 Value. The Portfolio has outperformed the Russell 2500 Value and delivered an average annual return since inception (January 2000) of 10.7% gross of fees versus 9.0% for the benchmark.

In terms of positive contributors, Lamb Weston, Air Transport Group, Agree Realty and Integrated Device Technologies added the most value for the quarter. The Portfolio's underweight exposure to energy also aided performance meaningfully given the eye-popping -42% return for the benchmark sector. Stocks that held back relative returns included Boingo Wireless, Zagg, and Spartan Motors. Despite another stellar earnings report and raised guidance, Boingo gave back last quarter's gains, but remained a winner for the full year.

We were active during the quarter given the opportunities presented by heightened volatility. New positions were initiated in Old Republic International, Atmos Energy, CareTrust REIT, and National Retail Properties. We also added to positions in LKQ Corporation and Cyrus One. To fund new purchases, we sold Quanta Services, Belden, Hilltop Holdings, Diamond Hill, Sunstone Hotel Investors, and Air Lease. We also trimmed several holdings including Cypress Semiconductor, Boingo Wireless and Air Transport Group.

For more details regarding full year 2018 attribution and our outlook for 2019, please dial in to our quarterly call on January 23, 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
AGREE REALTY CORP	2.96%	0.30%	BOINGO WIRELESS	6.33%	-2.98%
LAMB WESTON	3.24%	0.18%	ZAGG INC	2.68%	-1.02%
AIR TRANSPORT	2.39%	0.15%	AXOS FINANCIAL	2.89%	-0.84%
PINNACLE WEST CORP	2.37%	0.11%	META FINANCIAL	2.52%	-0.80%
INTEGRATED DEVICE TECHNOLOGY	2.64%	0.08%	SOLARIS OILFIELD INFRASTRUCTURE	1.90%	-0.77%

Top 5 Small Cap Value Portfolio Contributors			Bottom 5 Small Cap Value Portfolio Contributors		
Security	Avg. Weight	Contribution	Security	Avg. Weight	Contribution
AGREE REALTY CORP	3.42%	0.35%	BOINGO WIRELESS	6.32%	-2.98%
LAMB WESTON	4.06%	0.23%	ZAGG INC	2.74%	-1.05%
AIR TRANSPORT	2.40%	0.13%	SPARTAN MOTORS	0.67%	-0.94%
INTEGRATED DEVICE TECHNOLOGY	3.07%	0.10%	STAMPS.COM	2.63%	-0.89%
NATIONAL RETAIL PROPERTIES	1.39%	0.06%	SOLARIS OILFIELD INFRASTRUCTURE	2.17%	-0.88%

	Baird Small/Mid Value Composite Performance					Baird Small Value Composite Performance				
	QTD	1-Year	5-Year	10-Year	Since Inception (1/1/00)	QTD	1-Year	5-Year	10-Year	Since Inception (3/1/05)
GROSS OF FEES	-18.16%	-14.51%	4.75%	11.86%	10.67%	-17.96%	-15.05%	2.82%	9.98%	8.02%
NET OF FEES	-18.33%	-15.22%	3.94%	10.94%	9.69%	-18.01%	-15.42%	2.29%	9.25%	7.20%
INDEX*	-17.12%	-12.36%	4.16%	11.62%	9.02%	18.67%	-12.86%	3.61%	10.40%	6.12%

* 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.

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](#).

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 12/31/18. 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
Michelle Stevens, CFA Senior Portfolio Manager	26	7	MBA – (University of Cincinnati) BS – Economics (Wittenberg University)
Richard Roesch, CFA Senior Research Analyst	26	7	BS – Finance (Butler University)
Jonathan DeMoss, CFA, CPA, CFP Senior Research Analyst	23	7	MBA – (Indiana University) BS – Accounting & Management (Iowa State University)
Rob Zwiebel Portfolio Specialist & Consultant Relations	28	7	BS – Finance (University of Dayton)
Jesse Parsons Trading & Operations Analyst	14	7	BBA – Finance & Marketing (University of Kentucky)