

### MARKET COMMENTARY

Market participants dusted off their party hats early to celebrate the beginning of a new decade. Equity indices posted strong returns with the smallest of the small, non-earners and low quality leading the charge in the fourth quarter of 2019. Strong ETF flows of over \$7 billion since the fall made it tough for active small cap managers to keep up, and the average fund in only 1 of the 9 Lipper style boxes (Small Growth) beat its benchmark for the year. Despite a heroic effort in December, growth beat value again for the third year and 8 of the past 10.

Perhaps 2020 will break the streak as Russell 2000 Value earnings are forecasted in Factset to grow 16.7% versus 11.2% for the Russell 2000 Growth. Even better news for value is that although the forward price/earnings ratio for the Russell 2000 Growth is 26.7 (the highest since December 2001), the ratio for the Russell 2000 Value is only 15.6, a 21% discount to average.

Another significant macro trend influencing returns for the year was the outperformance of low quality. Although this bias was inconsistent throughout the year, the strong outperformance of low quality at year-end overwhelmed countertrends earlier in the year. Given our investment philosophy which favors high return on equity businesses, this prejudice created a strong headwind. As the charts below illustrate, relative valuations are compelling for quality which make it ripe for a snapback.



### BAIRD SMALL/MID CAP VALUE

For the quarter, the Baird Small/Mid Cap Value Portfolio underperformed the benchmark Russell 2500 Value with gross return of 5.1% versus 7.1% for the benchmark. The Portfolio was ahead of the Russell 2500 Value for the quarter through the end of November. The push into the year-end, however, favored Energy, Banks and Industrials; three areas where the Portfolio has less exposure than the benchmark. For the year the Portfolio returned 19.3% gross of fees versus the benchmark Russell 2500 Value return of 23.6% and 7.7% gross of fees for the trailing 3-years versus 6.1% for the Russell 2500 Value.

Performance for the quarter was aided by superior returns from our holdings in Health Care, Financials, Consumer Staples, and Consumer Discretionary. Individual holdings which outperformed include NMI Holdings, Davita, and Lamb Weston. The new position

### 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

we took in Cerence was also a top contributor for the period. Real Estate Investment Trusts, Industrials, Utilities and Communication sectors held back relative returns for the quarter. In particular, Cyrus One, a strong outperformer earlier in the year on takeover speculation, gave back gains upon the announcement that they would remain independent. Other stocks which hurt returns include CareTrust REIT and Southwest Gas, both of which lowered earnings estimates.

During the quarter we added to a number of current holdings that had declined in price and offered exceptional value including Deluxe, Boingo Wireless, CACI International, Astronics, and Southwest Gas. New positions were initiated in Patrick Holdings, Cerence, Merchants Bancorp and ON Semiconductor. Profits were taken in Hexcel, Lamb Weston, Physicians Realty Trust and Essential Property Trust to fund new purchases.

## **BAIRD SMALL CAP VALUE**

For the fourth quarter, the Baird Small Cap Value Portfolio underperformed the benchmark Russell 2000 Value with a gross return of 4.8% versus 8.5% for the benchmark. The Portfolio was performing in line with the Russell 2000 Value for the quarter through late November. The push into the year-end, however, favored Energy, Banks and Industrials; three areas where the Portfolio has less exposure than the benchmark. For the year, the Portfolio returned 18.1% gross of fees versus the benchmark Russell 2000 Value return of 22.4% and 6.3% gross of fees for the trailing 3-years versus 4.8% for the Russell 2000 Value.

Performance for the quarter was aided by superior returns from our holdings in Financials, Consumer Staples, Consumer Discretionary and an underweight to Energy. Individual holdings which outperformed include Zagg, NMI Holdings and Lamb Weston. The new position we took in Cerence was also a top contributor for the period. Real Estate Investment Trusts, Industrials, Information Technology and Communication sectors held back relative returns for the quarter. In particular, Cyrus One, a strong outperformer earlier in the year on takeover speculation, gave back gains upon the announcement that they would remain independent. Other stocks which hurt returns include CareTrust REIT and Southwest Gas, both of which lowered earnings estimates.

During the quarter we added to a number of current holdings that had declined in price and offered exceptional value including Deluxe, Boingo Wireless, Astronics, First American Financial, and Perspecta. New positions were initiated in Patrick Holdings and Cerence. Profits were taken in Hexcel, Lamb Weston, Physician Realty Trust and Essential Property Trust to fund new purchases.

Please contact us directly with additional questions or requests. Happy New Year and 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
NMI Holdings	3.02	0.71	CyrusOne	2.91	-0.59
Davita	1.99	0.56	Southwest Gas	2.88	-0.53
Lamb Weston	3.15	0.55	CareTrust REIT	3.00	-0.38
Leidos Holdings	3.61	0.50	Hexcel Corp	1.97	-0.22
ZAGG	1.66	0.43	Old Republic	3.22	-0.15

Top 5 Small Cap Value Portfolio Contributors			Bottom 5 Small Cap Value Portfolio Contributors		
Security	Avg. Weight	Contribution	Security	Avg. Weight	Contribution
NMI Holdings	3.10	0.72	Southwest Gas	3.30	-0.61
Lamb Weston	3.53	0.67	CyrusOne	2.95	-0.58
ZAGG	1.71	0.44	CareTrust REIT	2.52	-0.31
ICU Medical	2.55	0.41	Hexcel Corp	2.18	-0.24
Meta Financial	3.40	0.41	Old Republic	3.14	-0.14

	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	5.05	19.34	19.34	7.73	6.58	10.96	11.09	4.83	18.10	18.10	6.28	6.03	10.02	8.68
NET OF FEES	4.86	18.40	18.40	6.85	5.74	10.06	10.11	4.68	17.51	17.51	5.77	5.51	9.35	7.88
INDEX*	7.07	23.56	23.56	6.12	7.18	11.25	9.70	8.49	22.39	22.39	4.77	6.99	10.56	7.09

\* 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 12/31/19. 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)