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UNDISCOVERED MANAGER

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Baird Advisors' offices in downtown Milwaukee are far from the Southern California home of fixed-income powerhouses such as PIMCO, TCW Group, and Western Asset. On a visit with Baird's fixed-income team in April, the view from the conference room was not of the Pacific Ocean, but of a still-icy Lake Michigan. Yet, as dollars flowed out of PIMCO Total Return PTTRX after founder Bill Gross' abrupt departure from the firm in September 2014, Baird has been a big beneficiary, with close to $5.5 billion surging into Baird Core Plus Bond BCOIX between January 2014 and May 2015. While the firm has nowhere near the same scale or army of analysts as its West Coast competitors, its remarkably stable group of portfolio managers, a long-standing team-based approach to investing and plain-vanilla strategy have quietly won it dollars.

A Long-Tenured, Homegrown Team

The stability of the team at Baird Advisors, the institutional fixed-income asset-management team of R.W. Baird & Co., is clearly a significant draw. Led by firm chief investment officer Mary Ellen Stanek, the team is one of the longest-tenured in the industry. All six named portfolio managers, who in addition to Stanek include Gary Elfe, Charles Groeschell, Warren Pierson, Daniel Tranchita, and Sharon deGuzman, have run Baird Core Plus since its inception nearly 15 years ago. And the group goes back even further. Several members of the team, which joined Baird from Firstar Investment Research & Management Co. in 2000, have worked together for more than three decades. (The team's stability was partly responsible for the fund recently receiving a Bronze Morningstar Analyst Rating.)

That stability and long tenure is no accident. Stanek, who has relied on local talent to build the group, considers a good cultural fit a crucial component of the firm's hiring process. R.W. Baird CEO Paul Purcell's "no-jerk" rule (often expressed in livelier prose) is paramount. Stanek is clearly proud of the firm's 12 consecutive years on *Fortune's* 100 Best Companies to Work For list and more recently as the top-rated firm on *Pensions & Investments*' Best Places to Work in Money Management in its size category. Baird earns plaudits for its strong work-life balance, which includes a paid day off to employees to volunteer at a nonprofit of their choice.

Another key element of the culture is a commitment to developing talent. Indeed, Stanek is always thinking to the future. That means both a formal succession plan—Pierson is slated to eventually take over as the firm's next CIO, while Jay Schwister, who joined the firm from Putnam Investments in 2004, is expected to eventually replace Elfe as research director—and close attention to building the next generation of analysts. New analysts are brought on as generalists and are quickly involved in the day-to-day work of portfolio construction. Stanek says that this makes for well-rounded analysts

Staying Together: From left, Baird's Warren Pierson, Sharon deGuzman, Jay Schwister, Daniel Tranchita, Mary Ellen Stanek, Charles Groeschell, Gary Elfe, Meghan Dean and Jeffrey Schrom.

who will be prepared one day for more senior roles in the firm.

"We want people to think longer-term and see a clear career path if they outperform and work hard," she says.

She's also committed to maintaining a flat organizational structure where even the most junior analysts are encouraged to quickly add their voice to the investment debate.

Straightforward Approach

As many of its competitors have jockeyed for position with the launch of "unconstrained" and "absolute return" bond funds, Baird keeps things refreshingly simple. The firm sticks with cash bonds, and ever since 1985 when the team was at Firstar, it has eschewed broad bets on the direction of interest rates.

"We believe in the efficiency of the bond markets and don't think anyone can get those calls right consistently," says Stanek. "That frees up energy to focus on other things."

The team keeps the fund's duration in line with that of its Barclays U.S. Universal Bond Index benchmark, while making modest adjustments to its allocation to various bond maturities along the yield curve.

Security selection is at the core of the team's strategy, as has been a tilt toward credit since 2008's credit crisis. Baird Core Plus typically traffics heavily in BBB-rated corporate bonds, which occupy the lowest rung of the investment-grade universe, and it has the flexibility to hold up to 20% of its portfolio in below-investment-grade debt. In recent years, that stake has hovered around the low double digits. Within this position, nonagency mortgages have been a particular area of focus. Here, the team sticks to higher-quality securities originated before the credit crisis, with a focus on the most senior parts of the capital structure. Stanek notes even after a strong rebound from the depths of the credit crisis, this sector continues to offer attractive loss-adjusted yields.

However, this is not a team to go all-out on risk, even in Baird Core Plus, which lands at the aggressive end of its bond lineup. While some investors make big, higher-conviction bets and take short-term bouts of underperformance in stride, the goal here is to win by a little bit, year in year out or, in Stanek's words, to win for investors by "compounding consistency." That approach is reflected in the fund's goal of outpacing its benchmark by 25 to 75 basis points a year, a relatively modest range for a core-plus strategy. It's also embedded in the firm's compensation plan. Variable compensation accounts for long-term performance through five-year and since-inception gains, but one- and three-year results are equally weighted. The message is clear: It's not OK to have a stellar few years of performance and then lag dramatically when markets turn rocky. The fund's portfolio is built for lean times as well as more generous credit markets. So, even though the team is still relatively bullish on credit, it still holds a hefty slug of Treasuries that should provide valuable insurance should credit markets head south.

An Impressive Record

Since our last visit with Baird in mid-2008, the

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Baird Core Plus Bond BCOIX

Category	**Intermediate-Term Bond**
Expense Ratio (%)	**0.30**
Morningstar Rating	★★★★★
3-Yr Annl Total Rtn (%)	**3.1**
3-Yr Total Rtn % Rank	**20**

Data as of 06/30/2015

team has mostly delivered on its pledge of consistent returns. It suffered a rare misstep in 2008, when its nonagency stake ran into trouble against the backdrop of the subprime mortgage crisis. The fund ended up lagging its benchmark by a little more than 4 percentage points for the year, though its 1.8% loss for the year still outpaced roughly 60% of its Morningstar intermediate-bond category peers, some of which sustained double-digit losses. However, Stanek and the team report that the fund's position in relatively high-quality, senior nonagency mortgages ultimately recovered much of their value, while a preference for government bonds over corporates coming into 2008 served the portfolio well.

Since then, the fund has been a remarkably consistent performer, landing in its category's best third in every calendar year but 2013, when it just missed inclusion, and topping its benchmark every year. That all makes for an impressive long-term record, with the fund's 5.6% 10-year annualized gain through June—which includes the credit crisis and its aftermath—topping 90% of the competition and its benchmark by close to 90 basis points annually. The fund has also held in relatively well during rough periods for credit including the third quarter of 2011 and, more recently, the fourth quarter of 2014, reflecting Stanek and her team's careful attention to controlling risk.

A Commitment to Shareholders

Baird's solid culture and investors-first approach underlie its success. Well beyond the firm's long-tenured team, the commitment is apparent in its low fees: The 55-basis-point levy on Baird Core Plus' no-load share class ranks as reasonable relative to its competition, while the 30-basis-point expense ratio on its institutional share class, available with a $25,000 minimum, is a real steal. It's also encouraging that managers invest alongside shareholders in mutual funds and that the firm takes a careful approach to new fund offerings. The fact that the firm is 93% employee-owned, with Stanek responsible for vetting new product ideas, helps maintain that focus.

Rapid asset growth over the past couple of years in this strategy and the firm's investment-grade-only Baird Aggregate Bond strategy has taken the Baird Advisors' total assets under management to $32 billion as of March. That poses new challenges. Stanek and her team argue that they could invest up to $100 billion without making changes to strategy. However, they might have to add staff before then to maintain a high-touch client relationship model. And, in May, Baird announced that it added a three-person municipal-bond management team from BMO Global Asset Management, with plans to roll out additional muni funds.

It's clear that whatever the future brings, Stanek and her team will take a long-term view. "We don't want to be all things to all people," Stanek says. "We do want to grow, but in a focused way that is good for our investors." In a world wrestling with complexity, Baird's success doing so is worth noting. M

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Important Disclosure Information

Analyst Rating is the summary expression of Morningstar's forward-looking analysis of a fund. Morningstar analysts assign the ratings on a five-tier scale with three positive ratings of Gold, Silver, and Bronze, a Neutral rating, and a Negative rating. The Analyst Rating is based on the analyst's conviction in the fund's ability to outperform its peer group and/or relevant benchmark on a risk-adjusted basis over the long term. If a fund receives a positive rating of Gold, Silver, or Bronze, it means Morningstar analysts think highly of the fund and expect it to outperform over a full market cycle of at least five years. The Analyst Rating is not a market call, and it is not meant to replace investors' due-diligence process. It cannot assess whether a fund is the right fit for a particular portfolio and risk tolerance. Morningstar evaluates funds based on five key pillars—Process, Performance, People, Parent, and Price. Analysts assign a rating of Positive, Neutral, or Negative to each pillar. Analyst Rating Scale - Gold: Best-of-breed fund that distinguishes itself across the five pillars and has garnered the analysts' highest level of conviction. Silver: Fund with advantages that outweigh the disadvantages across the five pillars and with sufficient level of analyst conviction to warrant a positive rating. Bronze: Fund with notable advantages across several, but perhaps not all, of the five pillars.

The Morningstar five-star rating for the Institutional Class Baird Core Plus Bond Fund is the overall rating received among 932 Intermediate-Term Bond Funds. The fund received four stars for the three-year period among 932 Intermediate-Term Bond Funds, four stars for the five-year period among 819 Intermediate-Term Bond Funds and five stars for the ten-year period among 591 Intermediate-Term Bond Funds. Information as of 7/31/2015.

For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating based on a Morningstar Risk- Adjusted Return measure that accounts for variation in a fund's monthly performance (including the effects of sales charges, loads and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive five stars, the next 22.5% receive four stars, the next 35% receive three stars, the next 22.5% receive two stars and the bottom 10% receive one star. Each share class is counted as a fraction of one fund within this scale and rated separately, which may cause slight variations in the distribution percentages. Past performance is no guarantee of future results.

The overall Morningstar Rating for a fund is derived from a weighted average of the performance figures associated with a fund's three-, five- and ten-year (if applicable) Morningstar Rating metrics.

The average annual total returns for the Institutional Class of the Baird Core Plus Bond Fund as of June 30 are 1.91% for the one-year, 4.84% for the five-year and 5.55% for the ten-year periods and 6.33% since its September 29, 2000, inception date. The expense ratio is 0.30% and the minimum investment is $25,000.

The average annual total returns for the Investor Class of the Baird Core Plus Bond Fund as of June 30 are 1.77% for the one-year, 4.59% for the five-year and 5.30% for the ten-year periods and 6.06% since its September 29, 2000, inception date. The expense ratio is 0.55% and the minimum investment is $2,500 (IRA: $1,000).

Performance data quoted represents past performance. Past performance does not guarantee future results. Investment return and principal value of an investment in the fund will fluctuate so that an investor's shares when redeemed may be worth more or less than their original cost. The fund's current performance may be lower or higher than the performance data quoted. Investment results assume all distributions are reinvested and reflect applicable fees and expenses. For performance current to the most recent month-end, please visit bairdfunds.com.

The Barclays U.S. Universal Bond Index represents the union of the U.S. Aggregate Index, U.S. Corporate High Yield Index, Investment Grade 144A Index, Eurodollar Index, U.S. Emerging Markets Index, and the non-ERISA eligible portion of the CMBS Index. The index covers USD-denominated, taxable bonds that are rated either investment grade or high-yield. Some U.S. Universal Index constituents may be eligible for one or more of its contributing subcomponents that are not mutually exclusive. The index is unmanaged and is not available for direct investment.

The Fund may invest in mortgage- and asset-backed securities which may be subject to prepayment risk and thus may be more sensitive to interest rate changes than other types of debt securities. The Fund may also invest in U.S. dollar denominated securities issued by foreign issuers which involve additional risks including political and economic instability, differences in financial reporting standards and less regulated securities markets. Non-investment grade bonds involve greater risk of default and bankruptcy than investment grade securities. While the U.S. government has historically provided financial support to various U.S. government-sponsored agencies, no assurance can be given that it will do so in the future if it is not obligated by law. Baird Funds are offered through Robert W. Baird & Co., a registered broker/dealer, member NYSE and SIPC. Robert W. Baird & Co. also serves as investment advisor for the Fund and receives compensation for these services as disclosed in the current prospectus.

Investors should consider the investment objectives, risks, charges and expenses of the fund carefully before investing. This and other information can be found in the prospectus or summary prospectus. A prospectus or summary prospectus may be obtained by visiting bairdfunds.com or calling 800-444-9102. Please read the prospectus or summary prospectus carefully before you invest or send money.

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