

# Baird Short-Term Bond Inst BSBIX

An excellent team and process to match.

## Morningstar's Take BSBIX

<b>Overall Morningstar Rating™</b>	★★★★		
532 US Fund Short-Term Bond (30 Apr 2023)			
	3 Yr	5 Yr	10 Yr
	532 funds	476 funds	352 funds
Morningstar Rating™	3★	4★	4★
<b>Morningstar Medalist Rating</b>	Gold		
Analyst-Driven %	100.00		
Data Coverage %	100.00		
<b>Morningstar Pillars</b>			
Process (7 Feb 2023)	High		
People (7 Feb 2023)	High		
Parent (25 Mar 2022)	High		
Performance (7 Feb 2023)			
Price (7 Feb 2023)			

7 Feb 2023 | by Alec Lucas

Appreciation for how Baird Short-term Bond's capable and collaborative investing culture pairs with the firm's simple but effective style earns an upgrade of the investor shares' Morningstar Analyst Rating to Gold from Silver, while its institutional shares remain Gold.

Other top-tier firms may have bigger staffs and broader remits; Baird operates differently, and is excellent in its own right. Co-CIO Mary Ellen Stanek, winner of Morningstar's 2022 Outstanding Portfolio Manager award, and co-CIO Warren Pierson head this fund's veteran 10-person management team, whose members complement one another's strengths and stick to a straightforward, winning playbook.

Modest fees are critical to that playbook, allowing the team to focus on U.S. dollar-denominated bonds of investment-grade quality without the complications of derivatives or leverage. The approach begins with matching the Bloomberg U.S.

Government/Credit 1-3 Year Index's overall interest-rate sensitivity and then trying to add value through more repeatable means.

Security selection and sector allocation among corporates, securitized, and government bonds are among those means. As repeated interest-rate hikes weighed on the mortgage market in 2022 for example, the fund leaned in. The managers cut the portfolio's Treasury stake by about 7 percentage points to 29% and redeployed most of that money into what they regarded as more attractive high-quality nonagency mortgage exposure. Within corporate credit, they also increased the fund's financials overweight by year-end, even though it had hurt in the first two quarters.

The fund has enviable record. It has outperformed the benchmark in nine out of the past 10 calendar years and the distinct short-term bond Morningstar Category peer median in seven of them. In 2022, its institutional shares' 3.64% loss edged the index by 5 basis points and placed in the peer group's top quartile. The portfolio's corporate credit allocation, including financials, helped that year, but yield-curve positioning contributed the most.

The fund is a topnotch choice, especially for investors in search of a conservative option.

**Process** ● High | Alec Lucas | 7 Feb 2023  
 Focused on U.S.-dollar-denominated, cash bonds of investment-grade quality without the complications of derivatives or leverage, or the need to clear lofty fee hurdles, Baird Advisors' simple but effective investing style merits a High Process rating.

Citing the difficulty of predicting interest-rate changes consistently, Baird's approach begins with matching this fund's overall interest-rate sensitivity, or duration, to the Bloomberg U.S. Government/Credit 1-3 Year Index. Aiming to beat this bogy by 15 to 40 basis points per year, gross of fees, the team tries to add value through yield-curve

positioning, sector allocation, security selection, and competitive trade execution.

Security selection and sector allocation among corporates, securitized (both agency mortgages and non-agency, high-quality securitizations), and government bonds receive the most focus. Whether individual bonds, issuers, or sectors, the team looks for strong fundamental features, attractive relative value, and fit within its broader macroeconomic views. The team does not buy junk bonds but can hold onto debt that has lost its investment-grade rating—a stake that has been 2% or less for more than five years. The fund's credit profile as a result tends to look tame relative to more aggressive short-term bond Morningstar Category peers.

The hunt for value even extends to yield-curve strategies for Treasuries. The team looks for incrementally more attractive Treasuries when buying and sells those with the richest valuations.

Relative to its Treasury-heavy Bloomberg U.S. Government/Credit 1-3 Year Index, the fund tends to overweight corporate credit. It typically allocates about 50% to 55% of its assets to the sector, versus 22% to 24% for the index. Within corporate credit, the fund entered 2022 with a 10.1-percentage-point financials overweight that the team increased to 12.8 percentage points by year-end. The team continues to like financials, noting banks' generally stout capital positions and alignment of their management incentives with high ratings given that banks consistently need to access debt markets.

The fund's out-of-benchmark, higher-quality securitized stake ended 2022 at 13.5% of assets, up from 9.1% a year prior. As repeated interest-rate hikes weighed on the mortgage market in 2022, the fund leaned in. The managers cut the portfolio's Treasury weighting by about 7 percentage points to 29% and redeployed most of that money into nonagency mortgage exposure. At year-end, nonagency residential mortgage-backed securities,

nonagency commercial mortgage-backed securities, and asset-backed securities accounted for 3.5%, 4.4%, and 5.7% of assets, respectively.

Throughout 2022, the fund stashed around 30% of its assets in bonds with BBB ratings, roughly 20 to 22 percentage points heavier than the index. It added 4.4 percentage points of exposure to AAA bonds, ending the year with a 14.3% stake, versus 4.3% for the index.

**People** ● High | Alec Lucas | 7 Feb 2023

Appreciation for how Baird Advisors' capable and collaborative investing culture pairs with the firm's simple but effective style earns the fund a People upgrade to High from Above Average.

Other top-tier firms may have bigger staffs and broader remits; Baird operates differently, and is excellent in its own right. Co-CIO Mary Ellen Stanek, winner of Morningstar's 2022 Outstanding Portfolio Manager award, and co-CIO Warren Pierson head this fund's veteran 10-person management team, whose members complement one another's strengths and stick to a straightforward, winning playbook.

Alongside Stanek and Pierson, Charles Groeschell and research director Jay Schwister set the tone here; each has about 40 to 45 years of industry experience. The other managers have a wider range of experience but collectively represent the next generation. Lead Jeffrey Schrom and comanagers Andrew O'Connell and Abhishek Pulakanti work as part of a seven-person credit team; Meghan Dean and Patrick Brown oversee a seven-person securitized team; and M. Sharon deGuzman guides Baird's seven-person portfolio construction and risk group.

Stability is a strength. Apart from two retirements in 2020 and 2021, respectively, no manager has left since this fund's 2004 inception. There have also been only two analyst departures since 2016, both for personal reasons.

Fund ownership stands out, too. Managers invest in all their strategies, with three owning more than \$5 million each across the lineup.

**Parent** ● High | Alec Lucas | 25 Mar 2022

Baird's best-in-class stewardship attributes and investor alignment deserve a Parent rating upgrade to High from Above Average.

The firm's taxable-bond franchise, which boasts low fees, a well-resourced team, and a risk-aware investment process across its strategies, has garnered considerable investor attention over the past few years. It swelled from \$37 billion in 2016 to \$120 billion at the end of 2021, encompassing 85% of the firm's total \$139 billion in assets. This growth bears monitoring, but longtime CIO and lead fixed-income portfolio manager Mary Ellen Stanek has shown prudence in adding personnel and operational resources to manage this considerable load. She has also been circumspect in succession planning and elevated her veteran deputy Warren Pierson to co-CIO in October 2021. Though the firm's municipal-bond and equity franchises are much smaller, they also sport sensible leadership and many of the same positive attributes as the taxable fixed-income lineup.

Baird has long supported its investors by providing transparent reporting on its own firm and its investment rationale through timely market updates and webinars. Internally, the firm is also keen to encourage employee retention and engagement: Turnover among the firm's analyst staff has historically been low, and around two thirds of employees owned stock in the privately held firm at the end of 2021.

**Performance** | Alec Lucas | 7 Feb 2023

The fund has a strong long-term record. Since its 2004 inception, its institutional shares' 2.38% annualized gain through January 2023 beat the Bloomberg U.S. Government/Credit 1-3 Year Index by 39 basis points while placing in the top half out of nearly 75 distinct short-term bond Morningstar Category peers. Adjusted for volatility, results looked even better: the institutional shares' Sharpe ratio (a measure of return relative to standard deviation) was superior to the benchmark's and placed in the peer group's top quartile.

Consistent outperformance has been a hallmark here. Over the past decade through 2022, the fund has beaten its index in nine out of 10 calendar years and its distinct peer median in seven of them.

Versus the benchmark, the fund's best showing was in 2016, when its 2.25% return outpaced the index by 97 basis points. The fund's typical Treasury underweight was a headwind in that year's first two months amid a commodity selloff. Yet, bonding picking and overweighting BBB credit helped for 2016 as a whole, as did having energy and mining exposure when spreads tightened.

Overall, the fund has helped take the bite out of inflation, as measured by the Consumer Price Index. From its 2004 inception through December 2022 (the most recent month for which CPI data is available), the fund grew each initial dollar invested into \$1.53, versus the roughly \$1.57 required to maintain purchasing power. By contrast, the average peer (inclusive of all share classes) grew each initial dollar invested into \$1.38 over the same period.

**Price** | Alec Lucas | 7 Feb 2023

It's critical to evaluate expenses, as they come directly out of returns. Based on our assessment of the fund's People, Process, and Parent pillars in the context of these expenses, we think this share class will be able to deliver positive alpha relative to the category benchmark index, explaining its Morningstar Analyst Rating of Gold.

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The Data Coverage % data point is a summary metric describing the level of data completeness used to generate the overall rating. If the pillar is assigned directly or indirectly by analysts, the pillar has complete data availability, as no model was used to estimate the pillar score. If the pillar is assigned directly by algorithm, Morningstar counts the number of data points feeding both the positive and negative models and counts whether the vehicle has strategy-specific data available. A simple percentage is calculated per pillar. The overall data coverage % is then scaled by pillar weights.

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The Analyst-Driven % data point displays the weighted percentage of a vehicle's pillar ratings assigned directly or indirectly by analysts. For example, if the People and Parent ratings are assigned directly or indirectly by analysts but the Process rating is assigned algorithmically, the Analyst-Driven % for an actively managed vehicle would disclose that 55% of the pillar weight was assigned by analysts and the Analyst-Driven % for a passively managed vehicle would disclose that 20% of the pillar weight was assigned by analysts.

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#### **Equities**

Equities are typically subject to greater fluctuations in market value than other asset classes due to factors such as a company’s business performance, investor perceptions, stock market trends and general economic conditions. Stocks of small or mid-sized companies involve additional risks; such companies may have a higher risk of failure, are not as well established as larger blue-chip companies, and have historically experienced a greater degree of market volatility than the overall market average.

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### **Market Price Risk**

The market price of securities traded on the secondary market is subject to the forces of supply and demand and thus independent of the NAV. This can result in the market price trading at a premium or discount to the NAV, which will affect an investor’s value.

### **Market Risk**

The market prices of securities can fluctuate as a result of several factors, such as security-specific factors or general investor sentiment. Therefore, investors should be aware of the prospect of market fluctuations and the impact it may have on the market price.

### **Non-Diversified Strategies**

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[Click here](#) for the most recent Morningstar rating for Baird Short-Term Bond Fund and performance.

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