Q4 2023 Commentary and Market Outlook

Baird Equity Opportunity Fund

Baird Equity Asset Management

PORTFOLIO COMMENTARY

Fellow shareholders,

Equities bounced back in 2023, as easing inflation raised hopes for looser monetary policy and drove valuations higher. Smaller-cap stocks struggled for much of the year but posted a strong final two months, enabling the Russell 2000 Index to finish with a +14.0% gain for the quarter (+16.9% YTD), while the Baird Equity Opportunity Fund modestly underperformed with a +13.7% net return in the fourth quarter (+13.8% YTD).*

The Federal Reserve hiked interest rates another four times in 2023 while maintaining a steady pace of balance sheet reduction (quantitative tightening) to try and quell higher-than-normal inflation. As key price indexes peaked, investor focus shifted toward the timing of a potential Fed pivot toward loosening monetary policy. Investors bid up equities with a particular focus on larger cap technology stocks – the S&P 500 Information Technology Index rose a whopping 58% for the year. Within our target universe of smaller-cap stocks, bullish sentiment lagged but returns were solid, nonetheless. The Russell 2000 Industrial and Tech sectors led the way, up 29% and 28%, respectively.

The Equity Opportunity Fund's results were a bit frustrating since many of our positions suffered more from a lack of investor interest than any meaningful fundamental disappointment. Said differently, while the market at large benefited from rising valuations, it was more of a grind for our portfolio. Given the concentration of our book, the idiosyncratic nature of our holdings, and the team's willingness to take a view that runs counter to the market's prevailing wisdom, the portfolio can feel out of step from time to time – and this year it did. A few incremental factors seemed to challenge performance in the second and third quarters, in particular. First, in March, regional bank liquidity fears spiked and drove the Federal Reserve to employ a burst of "closet financial easing" to manage contagion risk. Then, in the spring, surprisingly strong results from artificial intelligence chip maker Nvidia drove animal spirits within the tech sector in search of the next AI winners. While neither had a measurable negative impact on the portfolio, we also did not have much upside leverage to these factors.

Ups and downs aside, the Equity Opportunity Fund had many winners during the year, including Blackbaud, Cadre Holdings, and Universal Display. Software-maker Blackbaud rose in lockstep with its strong results throughout the year, driven by accelerating revenue growth, strong margin expansion, and a newer pricing initiative that we believe will pay dividends for several more years. Cadre, a maker of public safety products, benefited from strong execution even during a period of declining law enforcement headcount. As the "defund the police" movement subsides and rising crime in many cities comes to the fore, we think municipalities will renew their efforts to combat violence and theft. If so, Cadre's array of non-lethal products should experience demand tailwinds, driving even better profit growth in the years to come.

Universal Display benefitted from investors' rising appreciation of the potential for the company's blue phosphorescent emitters (which increases OLED's materials revenue addressable market by 67%) and the market adoption of OLED displays in tablets and notebooks, beginning in 2024. Like many technology stocks, while 2023 revenue and EPS were relatively in line with beginning of the year expectations, valuation levels expanded meaningfully. We continue to anticipate above trend revenue and EPS growth over the next several years.

Our biggest detractors for the year were Infinera, Valmont Industries, and ZoomInfo. Infinera has been a tough stock to own for several years. Always mindful of potential value traps, we maintain the view that the company's optical products are best-in-class, management is strong, and optionality exists. Nevertheless, we acknowledge that our thesis has been derailed several times since initiating a position in 2019, including disruption from COVID in 2020, significant supply chain issues in 2021-2022, and uneven customer spending in 2023. We continue to exercise patience, as reacceleration in Infinera's core markets is likely and the benefits of the company's technological advancements and operational improvements should put the stock on better footing this year.

***Performance data represents past performance and does not guarantee future results. The investment return and principal value of the investment will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Current performance data may be lower or higher than the data quoted. For performance data as of the most recent month-end, please visit bairdfunds.com.**

Industrial manufacturer Valmont Industries weakened after a period of strong multi-year gains. With leverage to the farm economy through its leadership position in manufacturing irrigation equipment, trends softened in 2023 as corn prices fell from peak levels. The company has become much more than a farm equipment company and holds a leadership position in utility transmission and distribution infrastructure, a key part of America's ongoing electric grid upgrade. We continue to hold the stock and are biased to add to our position on further weakness.

ZoomInfo declined as the company's outlook for an extended period of decelerating revenue growth compressed the multiple investors were willing to pay for the stock. The company has many positive attributes such as a leadership position in its core market for contact databases, double digit secular growth, and very high operating margins. Still, investor enthusiasm tends to wane when a company moves the period for positive inflection out further into the future, even if for macro reasons. We anticipate key metrics and overall growth to improve in the latter part of 2024, and we remain optimistic about shareholder returns this year.

There is no getting around the fact that the Federal Reserve's actions – and words – move markets more than ever. Many of us on our team grew up as analysts during a time when the mantra "don't fight the Fed" became prominent, but investors rarely lost sight of corporate fundamentals and business models. To say the game has changed over the past few decades would be an understatement. A near singular focus on Fed policy, along with the rising prominence of systematic and quantitative investment strategies and an explosion of various gambling tools, including zero-day options, all make our style of longer-term investing tougher than it used to be.

Even so, we believe that opportunity is often borne out of the uncertainty, momentum, speculation, and volatility in the marketplace. Many of our holdings illustrate this point, including Mister Car Wash (consumer discretionary), Chefs' Warehouse (consumer staples), and Merit Medical Systems (healthcare). We added to Mister Car Wash at prices below our estimate of the firm's replacement cost. Chefs' Warehouse fell roughly 50% mid-year for no apparent reason – and then almost doubled after posting a single reassuring third quarter. Similarly, Merit Medical Systems fell 25% during the same mid-year slump, only to recoup a chunk of the loss by year end – in neither the fall nor the subsequent rise was there any major stock-moving news. Stock price movements such as these have become more commonplace, making it more important than ever to have exceedingly high conviction in our underlying investments.

We anticipate a higher degree of difficulty in managing money to persist. We admit that we do not fully comprehend the Fed's intent to loosen monetary policy so soon, especially given that core inflation is still running above the central bank's own target, and unemployment under 4% can best be described as "full." That said, lessons learned from the past force us to respect this pivot and how it could positively impact investors' risk appetite, equity valuations and, of course, stock prices. We also note that gains could have legs if swollen money market assets are redeployed into equities as interest rates retrench.

Lest one think the setup is sufficiently easy, other considerations must be weighed. For example, while the Fed may have called the top on this cycle's Fed Funds rate, the timing of rate cuts may or may not sync with investor expectations. Already, futures markets have taken the Fed's 75-basis point dot-plot for 2024 and re-imagined it into twice that much (with a near imminent start). Additionally, it seems apparent that the effects of prior tightening have weighed on corporate fundamentals, leading to slowing growth and a growing number of earnings disappointments. Significant and ongoing geopolitical tensions along with the November elections could also drive uncertainty and volatility throughout 2024.

Having said this, we are more constructive than not. Timing aside, more accommodative monetary conditions seem likely. Additionally, at some point, small caps should re-emerge and at least partially close the wide performance gap with larger cap stocks. And, most importantly, we believe the portfolio remains well-positioned to deliver positive alpha even while not losing sight of ever-present risks in the environment.

We have seen many plot twists in our time managing portfolios, and we suspect the new year will not disappoint on that front. We may not hold the crystal ball that others claim to possess, but we feel fortunate to have a time-tested investment process, decades of collective experience, emotional fortitude to find opportunity from volatility, and the humility to manage the risks that we cannot so readily see.

We wish you all a Happy New Year and we look forward to updating you again in April.

Respectfully,

Joe Milano

Baird Equity Opportunity Fund (Q4 2023)

PERFORMANCE

Periods Ending December 31, 2023[1] (%)	Total Return (%)	Average Annual Total Returns (%)					
	QTD	1 Year	3 Year	5 Year	10 Year	Since Inception (05/01/2012)	Expense Ratios (Net/Gross)[2]
Equity Opportunity Fund Institutional Class (net)	13.65	13.75	6.30	7.90	4.70	7.36	1.25 / 1.73
Equity Opportunity Fund Investor Class (net)	13.56	13.56	6.09	7.67	4.44	7.10	1.50 / 1.98
Russell 2000 Index	14.03	16.93	2.22	9.97	7.16	9.59	

[1]**Performance data represents past performance and does not guarantee future results. Returns over one year are annualized unless specified. The investment return and principal value of the investment will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the data quoted. Performance figures assume reinvestment of all dividends and capital gains. For performance data as of the most recent month-end, please visit bairdfunds.com*. 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. Please read the prospectus or summary prospectus carefully before investing.* Fund performance is net of fees.**

[2]The Net Expense Ratio is the Gross Expense Ratio minus any reimbursement from the advisor. The advisor has contractually agreed to waive its fees and/or reimburse expenses at least through April 30, 2025, to the extent necessary to ensure that the total operating expenses do not exceed 1.50% of the Investor Class's average daily net assets and 1.25% of the Institutional Class's average daily net assets.

TOP & BOTTOM CONTRIBUTORS

Top 5 Portfolio Contributors	Avg. Weight	Contribution
Blackbaud, Inc. (BLKB)	7.74	1.87
Chefs' Warehouse, Inc. (CHEF)	4.56	1.74
NeoGenomics, Inc. (NEO)	5.25	1.73
Cadre Holdings, Inc. (CDRE)	5.84	1.47
Equifax Inc. (EFX)	3.94	1.40

Bottom 5 Portfolio Contributors	Avg. Weight	Contribution
Illumina, Inc. (ILMN)	0.76	-0.37
Clarus Corporation (CLAR)	1.96	-0.45
Valmont Industries, Inc. (VMI)	3.19	-0.68
Oceaneering International, Inc. (OII)	2.80	-0.73
Patterson-UTI Energy, Inc. (PTEN)	3.71	-1.05

Investment Professional	Years of Experience	Team Since	Coverage Responsibility
Joe Milano, CFA Portfolio Manager	27	2013	Generalist
Chip Morris, CFA Analyst	37	2014	Technology
Scott Barry Analyst	27	2014	Consumer Discretionary & Consumer Staples
Ben Landy Analyst	15	2014	Industrials & Materials
Scott Mafale Analyst	8	2021	Healthcare

This commentary represents portfolio management views and fund holdings as of 12/31/2023. Those views and fund holdings are subject to change without notice. The performance of any single fund holding is no indication of the performance of other holdings of the Baird Equity Opportunity Fund. Past performance is no guarantee of future results.

Prior to December 12, 2021, the fund was managed in accordance with a different investment strategy. The Subadvisor became the Fund's subadvisor effective December 12, 2021. The performance results shown are from periods during which the Fund was managed by the Advisor prior to the retention of a Subadvisor.

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.

As a non-diversified fund, the fund may invest a larger percentage of its assets in a smaller number of companies compared to a diversified fund, which increases risk and volatility because each investment has a greater effect on the overall performance. The fund focuses on small- and mid-cap stocks and therefore the performance of the fund may be more volatile, less liquid and more likely to be adversely affected by poor economic or market conditions than investments in larger companies. The fund may invest up to 15% of its total assets in the equity securities of foreign companies. Foreign investments involve additional risks such as currency rate fluctuations, the potential for political and economic instability, and different and sometimes less strict financial reporting standards and regulation.

The Russell 2000 is the most widely quoted measure of the overall performance of small-cap to mid-cap stocks. It represents approximately 10% of the total Russell 3000 market capitalization. It is made up of the bottom two-thirds in company size of the Russell 3000 index. Indices are unmanaged and are not available for direct investment. Time periods greater than one year are annualized.

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.

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