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Baird Mid Cap Growth Institutional BMDIX

Industry veterans at the helm.

Morningstar's Take BMDIX

Overall Morningstar Rating™ ★★★

510 US Fund Mid-Cap Growth
(31 May 2024)

	3 Yr 510 funds	5 Yr 476 funds	10 Yr 382 funds
Morningstar Rating™	3★	3★	3★

Morningstar Medalist Rating™	Bronze
Analyst-Driven %	100.00
Data Coverage %	100.00

Morningstar Pillars	
Process (29 May 2024)	Average
People (29 May 2024)	Above Average
Parent (21 Feb 2024)	High
Performance (29 May 2024)	
Price (29 May 2024)	

29 May 2024 | by Stephen Welch

Baird Mid Cap Growth's experienced and adept managers ply a straightforward, quality-oriented approach, making it a solid choice for investors seeking US mid-cap growth exposure.

Manager Chuck Severson has overseen the strategy as its lead since its 2000 inception, and a similar separate account dating to 1993. Comanager Kenneth Hemauer has worked on the strategy since 2001 as an analyst, becoming a named manager in mid-2010. Six analysts round out the team, two of whom have over a decade of experience with the strategy.

Severson and the team utilize a straightforward approach with sensible guardrails. Quality comes first as they focus on profitable firms with durable competitive advantages and healthy balance sheets that can drive long-term reliable growth. They stick to companies within the market-cap range of the Russell Midcap Index and look for companies like long-time holding Fastenal, the largest fastener distributor in North America with a low debt/capital ratio and an above-benchmark return on invested capital.

Severson often pays a premium for above-average profitability in building the strategy's roughly 55- to 60-stock portfolio. Over the past decade, the strategy's trailing 12-month price/earnings ratio was on average roughly 20% higher than the Russell Midcap Growth Index's.

The strategy has gotten ahead by outperforming in down markets, but its quality focus can cause it to lag at times. For example, from the second half of 2023 through April 2024, the strategy's 1.0% cumulative loss lagged the index's 12% gain as two market obstacles coalesced. Healthcare picks such as Insulet weighed on results as it was hit by the potential impact from weight-loss drugs. Nonprofitable technology companies also got a boost as the generative artificial intelligence craze swept through the market.

Yet the ability to lose less in market pullbacks has resulted in lower volatility than the index and better risk-adjusted results during Severson's 20-plus years in charge. The managers' long-run track record suggests patience will be rewarded.

Process Average | Stephen Welch | 29 May 2024

The strategy's quality-oriented approach is straightforward and well-executed but doesn't stand out. It earns an Average Process rating.

Focused on stocks within the Russell Midcap Index's market-cap range, manager Charles Severson and his team look for companies with five characteristics: attractive margins, durable revenue growth, capable management, industry tailwinds, and favorable market expectations. The team pays attention to valuations, often using Wall Street research to aid in the process, but aren't afraid to buy expensive but well-run growers. Overall, though, the strategy typically favors profitable, debt-light firms that can maintain above-average earnings and revenue growth for at least three to five years.

The strategy uses a quant screen as a fundamentals-check and a technical screen to gauge sentiment, which helps it time buying and selling. However, it isn't beholden to those filters. Annual portfolio turnover isn't excessive, ranging between 26% and 47% in the past five years. While most holdings take up 1%-3% of assets, the strategy can build up to a 4% position in firms with quant and technical screen support and it holds on to them unless their growth slows.

The team is sector-aware and limits relative risk by keeping sector weightings to 75%-125% of the Russell Midcap Growth Index's. Severson will sell names whose market caps become too big for the benchmark.

This strategy is relatively compact across 55-60 stocks, its typical range since mid-2008, with around a fourth of assets in its top 10 holdings. Still, the strategy favors some sectors more than others, while shunning not-yet-profitable biotechnology firms and highly leveraged companies, including most REITs, utilities, and airlines.

This strategy provides consistent exposure to high-quality, growing companies, which often means it is paying a premium for them. Indeed, the strategy's average trailing 12-month price/earnings has averaged roughly 20% higher than the Russell Midcap Growth Index over the past five years. The team takes time to fully understand a company's business model and keeps a watchlist of roughly 10 stocks and will wait to buy a name from the list until the company's results improve.

Despite the high price multiples, this strategy sticks to established, profitable fare. Overall, the strategy's net margin levels have been higher and its debt/capital levels lower than the index during his tenure. While the index has held more than 15% of its assets in unprofitable companies, Charles Severson does not allow the strategy to own any nonprofitable companies as over the long term he feels profitable companies outperform.

Severson tries to keep this strategy as a true midcap offering and will sell a holding once a firm is reconstituted out of the index. In an atypical 2023, the team had to sell five holdings as they graduated out of the index.

People Above Average | Stephen Welch | 29 May 2024
This strategy's veteran managers support an Above Average People rating.

Lead manager Charles Severson has been in charge since the strategy's year-end 2000 inception, but his experience with the strategy goes beyond that. A 37-year veteran of Robert W. Baird & Co, Severson has used the same process on the separate account Baird Mid-Cap Growth Equity since June 1993, which successfully navigated the market drawbacks in 1998 and 2000.

Severson isn't alone. Comanager Kenneth Hemauer initially joined the strategy in 2001 as a financials and consumer analyst and became a named manager in mid-2010. Hemauer covers the financials sector.

The two managers work as part of a stable but growing eight-person team. Four have worked together for more than a decade, and one has been with the team for five years. The healthcare analyst and consumer analyst each came to the strategy more than 10 years ago. While the team's longtime industrials analyst retired last year, the managers hired a replacement who has five years of industry experience. The team is rounded out by two junior analysts hired in 2021 and 2022. Severson plans to add one or two more members during the next few years for additional support. This will ensure there is adequate help after launching a smid-growth strategy a few years ago.

Severson and Hemauer each have over $1 million in the strategy.

Parent High | Stephen Welch | 21 Feb 2024
Baird merits a High Parent rating.

Although Robert W. Baird and Co.'s origins date to 1919, its Milwaukee-based asset-management business has over the past 25 years grown into an industry stalwart through deft talent acquisition. In early 2000, Mary Ellen Stanek and her team joined to form the fixed-income-focused Baird Advisors. With modest fees and an effective, benchmark-aware approach, its taxable bond team now runs the lion's share of Baird's assets under management. The firm bolstered its municipal bond expertise in mid-2015 and in August 2019, and that part of the business now has considerable promise, too.

Although not as big or extensive in its lineup as its fixed-income counterpart, Baird Equity Asset Management has also opportunistically added key personnel. It purchased the international and global growth equity team of Chautauqua Capital Management in 2016 and in late 2021 strengthened ties with proven investor Joseph Milano, formerly of T. Rowe Price, while removing a small-value team that had struggled over the prior decade.

Succession bears monitoring. Indeed, Stanek and her co-CIO Warren Pierson are part of Baird Advisors' founding generation whose members each have nearly 40 if not more years of experience. That's offset, however, by a collaborative, team-based approach that should leave investors in good hands well after that generation's retirement.

Performance | Stephen Welch | 29 May 2024
The strategy has performed well under its longest-tenured manager, Charles Severson. Since his year-end 2000 start, the institutional shares' 8.1% annualized gain through April 2024 beat the Russell Midcap Growth Index's 7.9% and the typical mid-growth peer's 6.3%. The strategy has been less volatile than the index, resulting in superior risk-adjusted results.

The strategy derived much of its edge from faring well in volatile markets, like 2020's first-quarter coronavirus-driven plunge. It has delivered in most market corrections, like in the 2007-08 global financial crisis, 2012's second quarter, and late 2018's drawback. In 2022's market pullback, the strategy slightly lagged the index owing in large part to its energy underweighting and picks within healthcare and industrials.

The strategy can lag for extended periods, whether in rallies that favor more aggressive peers or value-oriented markets that reward the kind of income-oriented sectors it typically eschews. It finished behind the index each calendar year from 2013 to 2016 and 2020. From the second half of 2023 through April 2024, its 1.0% cumulative loss lagged the index by 12.9 percentage points as multiple headwinds coalesced. Healthcare picks such as Insulet weighed on results as it was hit by the potential impact from weight-loss drugs. Nonprofitable tech companies also got a boost as the generative AI craze swept through the market.

Price | Stephen Welch | 29 May 2024
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 Medalist Rating of Bronze.

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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 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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The average annual total returns for the Russell Midcap Growth Index as of May 31, 2024, are 21.91% for the one-year, 11.06% for the five-year and 10.67% for the ten-year periods and 7.94% since the fund's inception.

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