Baird Short-Term Bond Inst BSBIX

Simple and effective.

Morningstar's Take BSBIX

Overall Morningstar Rating™	★★★★		
536 US Fund Short-Term Bond (29 Feb 2024)			
	3 Yr 536 funds	5 Yr 495 funds	10 Yr 358 funds
Morningstar Rating™	3★	4★	4★

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

Morningstar Pillars	
Process (6 Feb 2024)	High
People (6 Feb 2024)	High
Parent (21 Feb 2024)	High
Performance (6 Feb 2024)	
Price (6 Feb 2024)	

6 Feb 2024 | by Alec Lucas

Baird Short-term Bond's conservative playbook means that it rarely wows in any given year, but over time its results serve investors well.

The team executing this playbook has had a lot of practice. Four of the 10 named managers worked together for years before this fund's August 2004 inception and even before joining Baird Advisors in early 2000. As colleagues at a prior firm, they honed a team-oriented investment philosophy centered on keeping fees low and adding value without taking undue risk. Standard-bearers Mary Ellen Stanek, Warren Pierson, Charles Groeschell, and Jay Schwister have passed on that philosophy and its practice to the next generation, including relative newcomers Andrew O'Connell and Abhishek Pulakanti. They both became named managers here in May 2022, though each has been at Baird Advisors for more than 10 years.

The approach is simple but effective. Sticking to U.S.-dollar-denominated bonds without the complications of derivatives or leverage, it begins with matching the Bloomberg US Government/Credit 1-3 Year Index's overall interest-rate sensitivity, or duration. Relative to more aggressive short-term bond Morningstar Category peers, the team is cautious about credit risk. While it can hold on to bonds that have lost their investment-grade rating, it does not buy them. The portfolio's junk bond allocation has been less than 2% since 2021 and at year-end 2023 its 0.7% stake in debt rated below BBB ranked in the peer group's bottom half.

Deft security selection and sector rotation among corporates, securitized, and government bonds are how the team adds the most value. For example, the portfolio's industrials overweighting within the corporate bond sector went from 17.1 percentage points in September 2022 to 13.5 percentage points by the end of 2023 as credit spreads tightened. Meanwhile, the team added 2.5 percentage points of exposure to nonagency commercial mortgage-backed securities over that period as valuations became attractive.

Recent performance has been competitive. Moves within industrials were an area of strength for the portfolio in 2023. Over the calendar year, the institutional shares' 5.65% gain beat the index by 104 basis points and was in line with the distinct peer norm. Over longer stretches, this fund has edged most peers, especially its volatility-adjusted results. That's likely to continue.

Process High | Alec Lucas | 6 Feb 2024
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 US Government/Credit 1-3 Year Index. Aiming to beat this bogy by 15-40 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 corporate, securitized (both agency mortgages and nonagency, 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 on to 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 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 US Government/Credit 1-3 Year Index, the fund tends to overweight corporate credit. It typically allocates about 50%-55% of its assets to the sector, versus 22%-25% for the index. Within corporate credit, the fund's financials overweighting increased to 18.7 percentage points in 2023's third quarter from 10.1 percentage points at the start of 2022. The team liked banks' generally stout capital positions and alignment of their management incentives with high ratings given that banks consistently need to raise debt. By the end of 2023, financials holdings, especially non-U.S. bank debt, had helped the fund, as did bond picks in technology issuers.

The fund's out-of-benchmark, higher-quality securitized stake ended 2022 at 16.8% of assets, up from 9.1% two years prior. As repeated interest-rate hikes weighed on the mortgage market in 2022, the fund leaned in that position. The managers cut the portfolio's Treasury stake and redeployed most of that money into nonagency mortgage exposure. Treasury holdings ticked back up in 2023, but the team continued to add exposure to nonagency residential MBS, nonagency commercial MBS, and asset-backed securities, which accounted for 4.5%, 5.4%, and 6.9% of assets, respectively.

Throughout 2023, the fund stashed around 30% of its assets in bonds with BBB ratings, roughly 20 percentage points heavier than the index's stake. It added 2.8 percentage points of exposure to AAA bonds, ending the year with a 17.1% allocation versus 4% for the index.

People High | Alec Lucas | 6 Feb 2024
Baird Advisors' capable and collaborative investing culture pairs well with the firm's simple but effective style, earning the fund a High People rating.

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 40-45 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 nine-person credit team; Meghan Dean and Patrick Brown oversee a six-person securitized team; and M. Sharon deGuzman guides Baird's eight-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 2000 inception. There have also been only three analyst departures since 2016, each for personal reasons.

Fund ownership stands out, too. Nine of the 10 managers invest in all their strategies, with three owning more than $5 million each across the lineup and another four more than $1 million each.

Parent High | Alec Lucas | 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 | Alec Lucas | 6 Feb 2024
The fund has a competitive long-term record. Since its 2004 inception, its institutional shares' 2.52% annualized gain through January 2024 beat the Bloomberg US Government/Credit 1-3 Year Index by 42 basis points and placed in the top half out of nearly 75 distinct short-term bond category peers. Adjusted for volatility, results looked even better: The institutional shares' information ratio (a measure of excess return over excess standard deviation versus the benchmark) ranked in the peer group's top third.

Consistent outperformance versus the benchmark has been a hallmark here. Over the past decade through 2023, the fund has beaten its index in nine out of 10 calendar years. In 2016, for example, the fund's 2.25% return outpaced the index by 97 basis points. The fund's typical Treasury underweighting was a headwind in that year's first two months amid a commodity selloff. Yet bond-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 2023 (the most recent month for which CPI data is available), the fund grew each initial dollar invested into $1.61, just shy of the $1.62 required to maintain purchasing power. In contrast, the average peer (inclusive of all share classes) grew each initial dollar invested into $1.46 over the same period.

Price | Alec Lucas | 6 Feb 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 Gold.

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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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Bonds
Bonds are subject to interest rate risk. As the prevailing level of bond interest rates rise, the value of bonds already held in a portfolio declines. Portfolios that hold bonds are subject to declines and increases in value due to general changes in interest rates. Portfolios that invest in lower-rated debt securities (i.e., "junk bonds") involve additional risks because of the lower credit quality of the securities in the portfolio. The investor should be aware of the possible higher level of volatility, and increased risk of default. Tax- free municipal bond funds may be subject to state and local taxation and the Alternative Minimum Tax.

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.

International/Emerging Markets Securities Risk
Investing in international securities involves special additional risks. These risks include, but are not limited to, currency risk, political risk, and risk associated with varying accounting standards. Investing in emerging markets may accentuate these risks.

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Trading may be halted due to market conditions, impacting an investor's ability to sell a security.

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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.

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Portfolios that invest a significant percentage of assets in a single issuer involve additional risks, including share price fluctuations, because of the increased concentration of investments.

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Portfolios that invest exclusively in one sector or industry involve additional risks. The lack of industry diversification subjects the investor to increased industry-specific risks.

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The average annual total returns for the Institutional Class of the Baird Short-Term Bond Fund as of February 29, 2024, are 5.39% for the one-year, 1.90% for the five-year, 1.74% for the ten-year periods and 2.49% since its August 31, 2004, inception date. The expense ratio of the Institutional Class is 0.30%.

The average annual total returns for the Bloomberg 1-3 U.S. Government/Credit Bond Index as of February 29, 2024, are 4.58% for the one-year, 1.41% for the five-year and 1.24% for the ten-year periods and 2.08% since the fund's inception.

The Bloomberg 1-3 U.S. Government/Credit Bond Index is an index consisting of Treasury or government agency securities and investment grade corporate debt securities with maturities of one to three years. Indices are unmanaged and are not available for direct investment.

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