Baird Mid Cap Growth Equity

MARKET UPDATE

The first six weeks of the year continued the pattern in place for much of 2024, a rising stock market climbing on the back of a narrow group of companies which carried enough momentum to push equity indices to all-time highs. As the quarter progressed, however, questions arose regarding the untethered pace of AI-related spending as DeepSeek, a potentially cheaper alternative AI platform out of China, and rumblings about a moderation in Microsoft's datacenter appetite slowed a key component of positive market sentiment. In addition, the rise in policy uncertainty accompanying the President's commitment to enact meaningful global tariffs provided a catalyst for a sharp negative reversal in the equity market, eventually pushing stock prices into correction territory as the quarter closed.

PORTFOLIO COMMENTARY

For the quarter, the Baird Mid Cap Growth portfolio produced a negative return of -9.6%, net of fees, trailing the Russell Midcap Growth decline of -7.1%.*

Underperformance was concentrated in the first half of the quarter as the portfolio lagged during the sharp market advance. The portfolio's negative performance gap closed meaningfully as equity markets corrected, but not enough to generate full-quarter outperformance. The team continues to work on bolstering results, and we remain confident that our long-standing investment process can drive stronger relative performance, particularly in a changing and volatile investment landscape. The below dissects the key sectors that influenced performance: consumer discretionary, technology, industrials, and healthcare.

Post election, the consumer discretionary sector performed well and was viewed as a likely beneficiary of the new administration's economic policies. However, the rapid pace of change as the quarter unfolded, including Department of Government Efficiency (DOGE) reviews of spending, government worker layoffs, and the uncertainty surrounding tariffs took a toll on consumer confidence. As sentiment waned, questions intensified regarding the forward trajectory of consumer spending. Portfolio performance was quite strong on a relative basis as several holdings posted solid positive absolute returns, including BJ's Wholesale Club, Dutch Bros, and the two services businesses, Copart and Rollins. BJ's Wholesale Club value positioning and solid execution are allowing for continued good fundamental trends, while the services businesses are less influenced by short-term confidence issues. We believe Dutch Bros has a strong growth period ahead, although we are mindful that early-stage restaurants do not move in a straight line, and we trimmed the position after a very strong run early in the quarter. Avoiding severe weakness in larger benchmark weighted names, Trade Desk and Deckers, also helped offset portfolio holdings that began to anticipate a weaker consumer.

We continue to find interesting business models in the consumer sectors – we purchased DraftKings, Live Nation, and BellRing Brands during the quarter. DraftKings is a digital sports entertainment and gaming company. The online sports betting industry has quickly developed into a two-player market. As a result, we believe DraftKings is on the cusp of inflecting to material earnings growth as promotional and customer acquisition costs decline behind these favorable competitive dynamics. Live Nation is the market share leader in the global live entertainment event market. We believe the stock will appreciate over time in line with the anticipated strong growth in revenues and profits, supported by favorable industry trends. More recently, the company has been allocating capital towards owned venues, which should result in greater long-term profitability. We also purchased BellRing Brands, a nutritional beverage company, and while classified as a consumer staple, we will mention it here. The company's Premier Protein brand is the leader in the convenient nutrition category, which is experiencing favorable secular growth. We believe the dynamic of the brand's market share being twice that of its total distribution endpoints can provide a tailwind to brand revenue growth. To make room for new ideas, we sold Pool Corporation as valuation has not corrected enough in our view to offset the potential for continued softness in pool construction and maintenance-related spending. We sold our remaining position in homebuilder D.R. Horton following strong multi-year stock performance, as we see the company facing a more challenging outlook with consumer confidence moderating. Given the history of solid sector performance, we are encouraged to see positive results after a challenging 2024, particularly with the long-term outlook for the new holdings.

*Returns less than one year are not annualized. **The performance data quoted represents past performance. Past performance does not guarantee future results. Current performance data may be lower or higher than the data quoted. Returns are presented net of management fees and include the reinvestment of all income. Actual investment advisory fees may vary across accounts and result in different net returns. For performance data to the most recent month end, contact Baird directly at 800-792-4011.**

We continue to carry healthcare in an overweight posture relative to the benchmark. While the sector provided some buoyancy as the market pulled back, fundamentals have not yet strengthened broadly enough to generate outperformance. The transition to the new administration has introduced uncertainty into healthcare-related research spending, and the personnel turnover at the FDA has raised questions about drug development and approvals. We believe the resulting volatility can yield opportunities for favorable long-term returns when quality science and care meet societal health needs. We initiated a position in Illumina, the incumbent in the attractive and growing genomic sequencing industry, which is benefitting from the market's transition from research to clinical diagnostics and the associated growth in testing. Unfortunately, Illumina became entangled in geopolitics as China moved to restrict the company's ability to sell into the market. While the move may dampen a small portion of revenues, we added to our position as we believe the downward price move more than accounted for the potential impact. Market volatility also opened an opportunity to establish a position in West Pharmaceutical Services, a key manufacturer of products used in the pharmaceutical production process, diagnostic testing, and drug delivery. While West Pharmaceutical has faced a prolonged post-Covid destocking challenge, the quality of the core business as a profitable organic grower remains unchanged. We believe the stock's sizable selloff related to headwinds in the noncore contract manufacturing business. To free up proceeds for the purchases, we moved on from two long-term holdings, IDEXX Laboratories and ICON. The former on lower conviction in the business growth outlook against a high valuation, while ICON was sold following the company's reduced growth outlook which we believe may persist for several quarters.

The technology sector produced the largest underperformance in the quarter. Two industry groups, software and services, were the source of underperformance. The software mix in the portfolio performed poorly mostly due to declines in Datadog and Manhattan Associates. Datadog, known for its observability and security software, faced high expectations for its fourth quarter report; however, new comments on investment spending and a moderate revenue outlook for 2025 contrasted with management's record of strong growth and execution. Manhattan's results included a CEO change and lowered outlook for the upcoming year. We believe the distribution management software provider will resolve concerns as the year progresses given a history of beginning their year in a conservative position; however, the stock reaction was disappointing. Compounding the pullback in those two companies was the 12% gain in Palantir, which holds a very large benchmark weight. We do not own a position in the company based on our fundamental assessment of the business in context of a very high valuation. Two services companies in the portfolio, Globant and EPAM, hurt sector results as they weakened along with the market's assessment of the economic outlook. Regarding adjustments, we purchased Gartner, a leading technology research and advisory firm and a prior portfolio holding. We are encouraged by indications of business re-accelerating in an already high-quality, durable franchise. Next, we sold Dynatrace and Pure Storage, which allowed us to lower sector exposure as we view the interplay of fundamentals and valuation to be less attractive than in other portfolio sectors.

Industrials struggled on a relative performance basis as economic worries, spurred by the overhang from policy and potential economic weakness, impacted most industry groups within the sector. Only the aerospace industry, where we own HEICO, and the services industry, where we own Equifax, finished relatively unscathed. We moved weight out of the sector during the quarter, selling Ingersoll Rand and IDEX Corporation, due to their cyclical end markets – we sold Jack Henry as well. These changes allowed us to reallocate capital into existing holdings with better fundamental outlooks. The reinvestment back into the sector included instances where we saw outsized price pullbacks relative to our fundamental assessment, notably in Shift4 and BWX Technologies. Shift4 is a global consumer payments company that has successfully used innovation and acquisitions to build a strong franchise, particularly in hospitality and entertainment related verticals. While sensitive to the economic impact on consumer spending, we believe management's history of execution combined with what we view as a reasonable valuation will generate value over coming quarters. BWX Technologies, a unique provider of nuclear power solutions, experienced volatility as conflicting headlines suggested potential budget changes to military programs for nuclear submarines and ships that use the company's solutions. AI enthusiasm also worked its way into expectations as any company with alternative energy capabilities, microreactors in the case of BWX, was pulled into the narrative to a degree. We believe the company offers stable and growing earnings power and we were happy to increase our position when the share price retreated.

Other portfolio sectors netted to a neutral impact as positive contributions from financials, basic materials, and real estate offset the negative impact from the energy sector.

OUTLOOK

If we were to survey investors and ask for a word to describe the current market environment, a sure-fire contender for the most cited would be “uncertain.” To a degree, the environment most always is, but investors tend toward ascribing more certainty to a complex economy and market than is warranted. As confidence builds towards a consensus outcome, events can unfold that beg for the assessment of a different path forward – think of transitory inflation, DeepSeek implications for AI, or most recently draconian tariff levels. The fact that the prevailing wisdom regarding such large market trends can change so quickly, reminds us just how fragile the markets and consensus positioning can be – thus the reversals, corrections, and volatility. Our best remedy for the inherent and many times underappreciated market risk has been and always will be to build a diversified portfolio of strong businesses, where we focus on understanding management strategy and incentives, profitability, the strength of balance sheets, and long-term growth potential. We do not root for difficult markets, but because of our long-standing philosophy we do not fear them either.

As noted in our recent communications, we have work to do to recapture the performance shortfall the last several quarters compared to the benchmark, and we are focused on doing just that. On behalf of the entire team at Baird Equity Asset Management, thank you for your support of our Mid Cap Growth Strategy.

Baird Mid Cap Growth Equity (Q1 2025)

PERFORMANCE

Periods Ending March 31, 2025 (%)	Total Return (%)		Average Annual Total Returns (%)				
	QTR	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception (06/30/1993)
Baird Mid Cap Growth Composite (Gross)	-9.40	-9.40	-13.76	-1.87	10.62	8.74	11.30
Baird Mid Cap Growth Composite (Net)	-9.58	-9.58	-14.43	-2.60	9.81	7.96	10.65
Russell MidCap® Growth Index	-7.12	-7.12	3.57	6.16	14.86	10.14	10.12

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BAIRD MID CAP GROWTH INVESTMENT TEAM

Investment Professional	Years of Experience	Years with Baird	Coverage Responsibility	Educational Background
Chuck Severson, CFA Senior Portfolio Manager	38	38	Generalist	MS – Finance, The Applied Security Analysis Program BBA – Accounting and Finance (UW-Madison)
Ken Hemauer, CFA Co-Senior Portfolio Manager	31	31	Financials	MS – Finance, The Applied Security Analysis Program BBA – Finance (UW-Madison)
Jonathan Good Senior Research Analyst	25	18	Healthcare	MBA – (Northwestern University-Kellogg) BS – Applied and Biomedical Sciences (Pennsylvania)
Corbin Weyer, CFA, CPA Director of Research & Senior Research Analyst	15	15	Consumer Discretionary & Staples	BSBA – Finance and Accounting (Marquette University)
Karan Saberwal Senior Research Analyst	9	6	Information Technology	MBA – (Northwestern University-Kellogg) BE – Bachelor of Engineering (Army Institute of Technology, University of Pune)
Christopher Brennan Senior Research Analyst	6	1	Energy, Industrials & Materials	MBA – Finance (The Wharton School of Pennsylvania) BA – Economics and Mandarin Chinese (Washington University in St. Louis)
Josh Heinen, CFA Research Analyst	4	4	Generalist	MS – Finance, The Applied Security Analysis Program BBA – Accounting and Finance (UW-Madison)
Margaret Guanci Research Analyst	3	3	Generalist	BBA – Finance (UW-Madison)

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The strategy focuses on small- and mid-cap growth style stocks and therefore performance will typically be more volatile than the performance of strategies that focus on types of stocks that have a broader investment style. The strategy may invest up to 15% of its total assets in U.S. dollar denominated foreign securities and ADRs. Foreign investments involve additional risks such as currency rate fluctuations and the potential for political and economic instability, and different and sometimes less strict financial reporting standards and regulations.

Portfolio holdings and sector exposures reflect a representative account as of the date listed above and are subject to change without notice. A representative account is selected based on accounts with substantially similar investment policies, objectives, and strategies that closely resemble, or are most representative of, the strategy it represents. Individual accounts may differ from a representative account due to asset size, market conditions, and client guidelines.

The Russell Midcap Growth Index measures the performance of those Russell Midcap companies with higher price-to-book ratios and higher forecasted growth values. Indices are unmanaged and are not available for direct investment.

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