Q1 2025 Commentary and Market Outlook

Baird Small/Mid Cap Growth Equity

Baird Equity Asset Management

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

The Baird Small/Mid Cap Growth portfolio decreased -10.6% in the first quarter, net of fees, compared to the -10.8% decline in our primary benchmark, the Russell 2500 Growth Index.* While slightly outperforming in a down market is nothing to brag about, we remain encouraged about our relative performance improvement as we outperformed the benchmark for the second quarter in a row. Other than modest underperformance in technology and financials, all other major sectors drove positive relative returns in the first quarter.

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 and Dutch Bros. BJ's Wholesale Club's 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 strong run early in the quarter. Offsetting some of those gains was a sell-off in Boot Barn due to worries over future tariff exposure, despite solid quarterly results, in our view.

We continue to find interesting business models in the consumer sectors – we purchased DraftKings, Planet Fitness, 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. Planet Fitness is the largest franchisor and operator of high value, low price gyms in the U.S. Under new management, Planet Fitness is raising membership pricing and leaning into better marketing and an enhanced club layout. We believe these factors should improve franchisee sentiment and drive a step up in revenue growth over the next several years. We also purchased nutritional beverage company BellRing Brands, and though 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.

In healthcare, the strongest contributor to relative performance was Intra-cellular Therapies, which was acquired by Johnson & Johnson early in the year at a roughly 50% premium. While biotech companies often lack the stability that comes from a strong balance sheet and positive free cash flow, we continue to seek out commercial stage businesses with strong top-line growth. Several of our medical technology holdings also made positive contributions, particularly Penumbra, Insulet, and Masimo which all saw favorable stock reactions to quarterly earnings and calendar 2025 guidance. Those gains were offset by some smaller market cap and higher multiple positions such as PROCEPT BioRobotics and Glaukos. While the healthcare sector traditionally acts as a defensive sector during challenging economic periods, in our view, that is certainly not the case year-to-date. 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. While they had encouraging operating results, our life sciences (or "tools") positions were under pressure in the quarter, including Bio-Techne and Repligen. Despite these shorter-term headwinds, we believe the resulting volatility can yield opportunities for favorable long-term returns when quality science and care meet societal health needs.

*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.**

The industrials sector was also a modest relative contributor in the first quarter. To summarize, it was more of a "barbell" type sector, with defensive businesses providing solid performance, offset by stocks with growth prospects tied to AI data center spending. In particular, three positions (Watsco, UL Solutions, and EXLService) generated positive absolute returns despite an -11% return for the sector in the quarter. Kadant, Lennox, Simpson Manufacturing, and BWX Technologies also contributed to performance. Our decision to trim AAON and Everus Construction Group lessened the losses in these stocks as they sold off significantly when operating performance in the fourth quarter and forward guidance did not match high investor expectations. We added to several positions due to the high volatility in the quarter, including Shift4 and BWX Technologies. Shift4 is a global consumer payments company that 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 Technologies, 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.

After driving positive relative returns the prior three quarters, the technology sector detracted from performance in the first quarter of 2025. Much like industrials, portfolio holdings consisted of both several winning and losing positions; however, the downside unfortunately exceeded the upside. Earlier in the quarter, we made the decision to reduce exposure in the more cyclical positions – especially those exposed to AI spending trends with outsized gains last year. To prepare for potential negative volatility, we trimmed Pure Storage and Onto Innovation and sold SiTime and Astera Labs. While that proved beneficial to portfolio performance, holding onto several software positions (Manhattan Association, Vertex, and Globant) did not, as those companies noted softer-than-anticipated demand which led to conservative forward guidance below our expectations. We are frustrated by the magnitude of the sell-off in several positions, though we recognize this is also a function of a declining market environment that exacerbates any shortfalls. Conversely, we saw solid performance from four other software holdings, including CyberArk, Monday.com, Descartes Systems, and Elastic.

In our opinion, there is not much to discuss in the smaller sectors in our portfolio. Energy and financials were modest negative relative contributors, while real estate and consumer staples were slightly positive.

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.

On behalf of the entire team at Baird Equity Asset Management, we thank you for your support of our SMID Growth Strategy.

Baird Small/Mid Cap Growth Equity (Q1 2025)

PERFORMANCE

Periods Ending March 31, 2025 (%)	Total Return (%)		Average Annual Total Returns (%)			
	QTD	YTD	1 Year	3 Year	5 Year	Since Inception 09/30/2015
Baird Small/Mid Cap Growth Composite (Gross)	-10.42	-10.42	-4.61	-2.04	11.27	11.37
Baird Small/Mid Cap Growth Composite (Net)	-10.59	-10.59	-5.28	-2.80	10.38	10.47
Russell 2500 Growth Index	-10.80	-10.80	-6.37	0.55	11.37	9.11

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BAIRD SMALL/MID CAP GROWTH INVESTMENT TEAM

Investment Professional	Years of Experience	Years with Baird	Coverage Responsibility	Educational Background
Jonathan Good Senior Portfolio Manager	25	18	Healthcare	MBA – (Northwestern University-Kellogg) BS – Applied and Biomedical Sciences (Pennsylvania)
Ken Hemauer, CFA Senior Research Analyst	31	31	Financials	MS – Finance, The Applied Security Analysis Program BBA – Finance (UW-Madison)
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)
Chuck Severson, CFA Mid Cap Growth PM	38	38	Generalist	MS – Finance, The Applied Security Analysis Program BBA – Accounting and 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 2500 Growth Index measures the performance of those Russell 2500 companies with above average price-to-book ratios and higher forecasted growth values. Indices are unmanaged and are not available for direct investment.

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