Baird Mid Cap Growth Equity

A NOTE TO OUR CLIENTS

Before discussing the fourth quarter, we begin our letter with thoughts on our full year performance. In short, in 2024 we delivered results for our clients that fell far below our benchmark, and our own expectations. The portfolio's stagnate return compared to significant strength in our benchmark and across most parts of the stock market not only produced poor results for the year, but also negatively impacted our average annual returns over the long-term time periods. The underperformance is nothing short of disappointing, and we are frustrated that we did not generate better returns for clients.

When we assess 2024, too many long-time holdings that drove several years of strong returns stopped contributing to performance, and in many cases severely hurt results. Collectively these companies that have historically been high-return and consistent growers, such as CDW Corporation, DexCom, Five Below and IDEXX Laboratories, experienced more cyclicality than we expected. As a result, the overall growth rate of the portfolio slowed directly into an environment where benchmark performance called for faster growth, with valuation levels taking a back seat. Also, additions to the portfolio, particularly those in 2023, failed to take the baton and help offset the moderation in long-term holdings. New ideas need to build on those prior in order to construct a strong performance record.

As expressed in our client communications, the influence of overarching factors such as the performance of profitable versus unprofitable companies, large versus small cap, and price momentum, will go through periods of hurting and then helping – some longer or more impactful than others. The environment and general headwinds over the past 18 months have been challenging, and we accept these ebbs and flows; however, the missed stock calls are disappointing and have our full attention.

Your co-portfolio managers have worked together for over two decades and the tenure of other key members of the investment team spans more than a decade. We have been through market cycles together – good and bad. We firmly believe we have the experience and resilience to move past this period and drive improved performance. Our long history tells us the best course of action is to stay committed to our long-standing investment philosophy. We manage a true mid-cap portfolio comprised of high-quality companies – underpinned by strong profitability, balance sheets, and attractive growth. While a shift in the investment environment can turn performance quickly, we are focused on what we can control, which is to stack good investment decisions – one at a time.

Q4 2024

MARKET UPDATE

The market moved through three distinct phases in the fourth quarter, defined almost exactly by the monthly turn of the calendar. October offered a period of market churn with little progress into the election. Equity markets moved sharply higher in November with the election serving as a catalyst, which was either a reaction to the potential policy direction under a new administration, relief that the election was finally over, or a little of both. A portion of the market advance unwound in December in response to sticky inflation readings, which led longer-term interest rates to move sharply higher. The net of it all was a solid advance in the overall equity market which finished the year near all-time highs.

PORTFOLIO COMMENTARY

For the quarter, the Baird Mid Cap Growth portfolio produced a negative return of -1.3%, net of fees, trailing the Russell Midcap Growth increase of +8.1%.*

The quarter was a microcosm of the year, with a combination of market factors and individual stock performance combining to hold results well below the benchmark. As mentioned in the opening paragraph, we are dissatisfied with performance, and the equity market's risk-on posture following the election along with the increased concentration of the benchmark only served to exacerbate performance headwinds. The paragraphs that follow discuss company and positioning challenges that negatively impacted results as well as portfolio changes we made.

*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 gross and 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'll start with the technology sector which performed poorly, accounting for two-thirds of the portfolio's relative underperformance in the quarter. Not owning AppLovin and Palantir negatively impacted results all year with that dynamic only accelerating during the fourth quarter. Both software stocks more than doubled in the quarter and contributed over half of the index's quarterly return. The two companies finished the year at a combined 8.0% weight in the benchmark – an unprecedented level. It was an active decision for us not to own either company based on a combination of concern about the valuation levels (70 times sales for Palantir and 25 times for AppLovin), and the fundamentals of the business models. To date, our view has been wrong and that has hurt meaningfully. We continue to assess the companies, but do not plan on "tying off" the benchmark weights as we have always believed that each portfolio position must be earned on merit. Outside of those two companies, the portfolio's software mix performed in line with the benchmark with Descartes Systems and new holding Datadog outperforming. We believe Datadog, an observability and security platform business for cloud applications, can continue to deliver high levels of profitable growth.

The portfolio's semiconductor exposure accounted for the remaining sector underperformance. Long-time holding Monolithic Power Systems suffered from a negative research report which questioned the sustainability of the company's product market share with Nvidia. We believe the company's products are critical to the development of AI-related chips and that the price dislocation created an opportunity to add on weakness. Microchip also performed poorly; we misjudged the anticipated recovery in the company's end markets, notably manufacturing-related, which has been pushed out several quarters.

We continued efforts to better position the technology sector and made multiple changes, including the purchase of Pure Storage, a leader in high performance storage solutions that combine hardware with proprietary software solutions. A recent contract win with a cloud hyperscaler provides exposure to artificial intelligence datacenter spend, driving incremental revenue opportunities. We sold Onto Innovation as a source of capital for the Pure Storage investment given our lower confidence in the Onto risk/return profile against market expectations. We also sold our position in ANSYS given better opportunity in other technology holdings, including Globant, and previously mentioned adds to Monolithic Power and Datadog. We purchased a new position in Hub Spot, a cloud-based customer relationship management platform. We see upside potential in the stock following a pullback in valuation and expected benefits from multiple product cycles, along with the potential for share gains from distracted competitors. We note that both Datadog and Hub Spot have recently moved to profitability, a long-standing requirement and discipline that keeps us investing in the strongest long-term businesses. We are encouraged that both companies help lift the growth profile of the sector and overall portfolio.

Quarterly performance from the industrial sector was subpar. Softness in parts of the industrial complex and higher interest rates impacted several holdings. Long-term portfolio stalwarts HEICO and Ingersoll Rand posted more mixed results in the quarter leading their stocks to pull back. Equifax declined given a key swing factor in earnings is the level of mortgage activity, which has been bottoming for an extended time. We believe there is meaningful earnings power that can flow through the company's income statement when pent up housing demand translates to higher purchase activity. Ferguson, a distributor of plumbing and HVAC construction and maintenance related products, also underperformed after reporting a quarter with muted growth that may hinder near-term margin improvement. Despite the year-to-date performance setback from the sector, we believe the portfolio holds a solid lineup of companies, and therefore sector changes were limited to a trim in HEICO to fund an add to Equifax.

Healthcare continued to struggle compared to other sectors and our overweight position was a headwind to performance. Strong performance from Penumbra and better performance from diabetes related holdings, Insulet and DexCom, was more than offset by a misstep in quarterly results from long-time holding ICON which reported a softer outlook due to heightened spending restraint from large pharma customers. Additionally, IDEXX sold off on slower reported growth and Repligen also underperformed. We trimmed IDEXX as we believe the position warrants lower capital given the slower growth profile. We also reduced weight in Veeva and ICON and increased our position in Penumbra, where we have higher conviction in the near-term fundamental outlook. This sector has been a source of strong long-term performance, and we believe the difficulty of the last few years offer the opportunity to recover some of the portfolio's shortfall as we move forward.

The impact of higher rates mentioned in the industrials sector discussion also found its way into our consumer discretionary holdings. Of note, homebuilder D.R. Horton and flooring retailer Floor & Décor declined as mortgage rates rose. We believe the positive secular demand for housing remains, but higher rates can suppress activity in this segment. In the meantime, we believe the two companies can consolidate market share given their strong competitive positions. Several other sector holdings outperformed, including BJ's Wholesale Club, Burlington Stores, Copart, and Dutch Bros.

OUTLOOK

While our results have been disappointing, we are encouraged by the performance we are seeing from holdings introduced to the portfolio in 2024, and notably several in the second half of the year. Positive contributors in the fourth quarter were found across sectors: AAON in industrials, Raymond James in financials, Vertiv and Datadog in technology, Dutch Bros in consumer discretionary, and Penumbra in healthcare. It will be a continuation of solid new idea generation that leads us out of a rough performance period.

The portfolio's underperformance compared to the benchmark has been much deeper and persisted longer than we would like. A combination of market characteristics and stock picking challenges have tested the portfolio. While the timing of a more favorable backdrop for our investment style is uncertain, we will remain focused on executing on our investment process. Remaining steadfast to our philosophy has served as the foundation of a solid investment record over our long history.

We appreciate the patience of our investors as we work through a challenging period. 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 (Q4 2024)

PERFORMANCE

Periods Ending December 31, 2024 (%)	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)	-1.07	-0.20	-0.20	-4.13	8.14	10.32	11.75
Baird Mid Cap Growth Composite (Net)	-1.25	-0.93	-0.93	-4.84	7.36	9.52	11.10
Russell MidCap® Growth Index	8.14	22.10	22.10	4.04	11.47	11.54	10.46

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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	14	14	Consumer Discretionary & Staples	BSBA – Finance and Accounting (Marquette University)
Karan Saberwal Senior Research Analyst	8	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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The Mid Cap Growth Equity Composite consists of all fully discretionary mid cap growth equity accounts. We invest in medium sized, high quality growth companies holding leadership positions within their industries that we believe are capable of producing above average growth in a variety of market environments. For comparison purposes, the composite is measured against the Russell Midcap Growth Index. Robert W. Baird & Co. Incorporated is an independent registered investment advisor. Registration does not imply a certain level of skill or training. Baird Equity Asset Management claims compliance with Global Investment Performance Standards (GIPS®). GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of content contained herein. To receive a complete list and description of composites and/or a GIPS Composite Report, please contact Baird Equity Asset Management at 800-792-4011. The U.S. Dollar is the currency used to express performance.

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