



Baird Investment
Management

*From Baird Investment Management's
Large Cap Growth Select Equity Investment Team:*

Large Cap Growth Select 4th Quarter 2011

Market Update

On the heels of a severe third quarter sell-off, equities rallied in the final months of the year. Strong corporate earnings and improved consumer sentiment, coupled with moves by European leaders intended to alleviate the sovereign debt and banking crisis, provided some optimism through the end of 2011.

Baird Large Cap clients more than participated in the fourth quarter rally, outpacing our primary benchmark, the Russell 1000 Growth® index, which advanced 10.6%. The market's broad advance played well into our investment strategy, which is focused on identifying large cap companies in the earlier part of their life cycle (generally less than average cap) where we believe there may exist a meaningful runway for attractive growth.

Portfolio Commentary

The market advance during the fourth quarter, particularly in October, stood in stark contrast to the late summer swoon in stock prices. Most domestic equity indices posted double-digit returns in the year's final three months as the U.S. economy strengthened and corporate profits continued to march higher. The market advance was not a sure thing as news from Europe remained challenging. In addition, U.S. politics failed to inspire confidence. The direction of important domestic structural issues such as tax policy, entitlement reform, and budget reductions may not be made clear until November. Resulting political uncertainty may have a dampening effect on multiples paid for company earnings during much of 2012.

The portfolio remained positioned for an economic recovery, although we moderated that structure during the second half of 2011. We believe it is prudent to plan for a wide range of outcomes and the possibility that the improved economic conditions of the fourth quarter may fade somewhat in the New Year. We note that earnings comparisons will be more challenging, particularly in the first half, and global growth, particularly in Europe, will likely decline further.

A review of benchmark dynamics shows that all sectors advanced in the quarter and those traditionally viewed as more offensive, including materials and industrials, led the way. We were pleased that portfolio holdings in the majority of economic sectors assisted in the overall outperformance during the fourth quarter, with our industrials and consumer discretionary stocks the only areas lagging the benchmark. Shares in the energy and health care sectors were the largest contributors, followed by basic materials, financials, and technology. Companies with strong earnings, cash flow, and superior balance sheets continued to be rewarded in the quarter.

The energy and materials sectors were the strongest performing components of the broader benchmark. Relative portfolio performance was also favorable as good stock selection added value. Commodity price action was mixed during the quarter although the price of oil stood out

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as it rebounded sharply. Because the materials sector responds actively to economic momentum, we moderated our exposure to account for increased uncertainty. Our pursuit of less commodity-exposed businesses proved beneficial. We lean toward quality companies such as Fastenal and Praxair, which outperformed. These businesses are impacted by the economy, but are not tied to the price level of a particular commodity. Our energy holdings performed well as the diversified mix of businesses reacted favorably to the rise in crude oil prices. We added a new position in Oceaneering International, a provider of services and products for deepwater drilling. We continue to believe that long term global supply/demand dynamics favor an active period of energy exploration & production.

After struggling in the past two quarters, our technology holdings rebounded nicely and made a solid contribution to portfolio outperformance. Akamai and F5 Networks rose sharply after disappointing third-quarter performance. We also lifted the sector weight modestly by adding to the Altera position on price weakness and increasing the Oracle and Qualcomm positions. Enterprise technology remained challenged as the higher multiples compressed on spending uncertainty. Technology still looks to be an area that we believe could provide opportunities should economic data and the European Union situation stabilize given its economic sensitivity and pullback in many segments of the sector during 2011.

Economic uncertainty and a more active regulatory climate continued to hurt financials during much of the year; however, the sector more than participated in the fourth quarter rally. The portfolio is basically equal weight the sector and benefitted from a rebound in companies with capital market exposure such as State Street and T. Rowe Price. Aflac also performed well, as worries over the company's investment portfolio and its exposure to sovereign debt lessened, while its core business of selling supplemental insurance in the U.S. and Japan performed well.

The portfolio's health care holdings produced strong performance in a sector that generally lagged the benchmark's strong advance due to its defensive nature. The challenge in recent years is that health care has not only been influenced by the economy, with lower utilization and spending, but also a difficult political environment. As a result, we remain underweight the sector and are focused on finding businesses with unique products or solutions that offer attractive growth prospects despite economic or political headwinds.

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The portfolio's consumer discretionary stocks lagged during the quarter as solid performance from specialty retailers such as O'Reilly Automotive and Urban Outfitters was offset by a decline in Amazon's share price. Amazon continued to post strong revenue growth, but increased spending which should build the foundation for future growth has given some investors pause. Auto part makers also recovered nicely during the quarter reflecting the anticipated ramp up in vehicle production schedules and ultimate sell through to car buyers. Despite persistently high unemployment, consumer spending has churned to higher levels and is now above its prior peak. Recognizing the uncertainty still facing the global economy and its affect on consumers, we have worked to balance the sector holdings with the higher economic and growth expectations found in companies like Tractor Supply (retailer of farm and ranch supplies), which was a new addition, with more defensive business models such as O'Reilly and Dollar General.

The portfolio's industrial stocks created the largest headwind to relative performance. While most portfolio holdings in the sector advanced, they trailed stronger benchmark performance, which was driven by more favorable U.S. economic activity. We continue to see very good earnings potential among many industrial and related names and remain overweight the sector. We did moderate the portfolio exposure by trimming Paccar, which is impacted by the potential push out of heavy-duty truck orders in a less certain economic environment. As we have

articulated in past letters, managements of many industrial companies have done a good job controlling cost during the economic cycle, allowing revenue growth to be levered into stronger earnings.

Outlook

As we flip the calendar to a new year, it is our belief that macroeconomic factors will again dominate the investment landscape in 2012. Sovereign debt and banking crises, central bank decisions, and global politics are front and center in the minds of investors, and rightly so. Resolution and clarity would be welcome – potentially lifting both spirits and earnings multiples for shareholders. Fortunately, domestic company fundamentals generally remain rather positive, providing some degree of comfort.

European sovereign debt challenges have been intensely discussed and debated, with steps taken, but few concrete accomplishments. Because so much country debt is held by the banking system, it is difficult to structure a solution that requires austerity measures, asset write-downs and capital raising without inducing at least a modest recession in Europe. The stronger northern economies (i.e., Germany and France) are being pressured to provide the lifelines necessary to manage the debt situation. Recapitalizing the banks will possibly require TARP-like financing. These are big, but not impossible tasks. We are closely monitoring our companies with European exposure with an eye to further reducing position sizes where appropriate.

The Chinese central bank maintained a restrictive monetary policy through much of the past year in order to reduce raw material and real estate inflation. Those efforts have largely been successful, but have also slowed GDP growth to a rate below their stated goals. It is not outside the realm of possibility that the breaking mechanism is reversed in 2012. This change would provide welcome relief for many companies that generate revenues and profits from that important growth economy.

Aside from our country's own debt and budget situation, 2012 is a Presidential election year. Uncertainty regarding the path of key issues including tax policy, federal budget cuts, and entitlement reform may be with us for much of 2012, and may well keep a lid on stocks. Better clarity and confidence would make for a more favorable investing climate.

In sum, risks remain elevated but we believe the U.S. economy is making progress, and we have positioned the portfolios accordingly. We are confident that our investment process is sound and our strategy will add long-term value for clients. Thank you for your support of Baird Investment Management. Happy New Year!

The Baird Investment Management Large Cap Growth Select Equity commentary is incomplete if not accompanied with the most recent performance report.

The Russell 1000® Growth Index measures the performance of those Russell 1000® companies with higher price-to-book ratios and higher forecasted growth values. The Russell Indices are a trademark of the Frank Russell Company. The S&P500 composite index is an unmanaged, market capitalization weighted index of 500 common stocks widely regarded to be representative of the market in general. Returns include the reinvestment of dividends.

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Tenured Large Cap Growth Select Investment Team

- All team members have equity ownership
- Deep sector expertise
- Average years of experience: 19 years

Investment Professional	Years of Experience	Years with Baird	Coverage Responsibility	Educational Background
Doug Guffy <i>Senior Portfolio Manager and Analyst</i>	28	7	Energy Large Cap Industrials & Materials IT – Large Cap Software	MBA – Finance (Ball State University) BA – Economics & Government (Anderson University)
Ken Hemauer, CFA <i>Senior Portfolio Manager and Analyst</i>	18	18	Financial Services Consumer Discretionary IT-Business Services	MS – Finance - The Applied Security Analysis Program BBA – Finance (UW – Madison)
Reik Read <i>Senior Research Analyst and Director of BIM</i>	14	12	IT-Electronic Manufacturing Business Services	MBA – (UW – Madison) BS – Economics (UW – Madison)
Jonathan Good <i>Senior Research Analyst</i>	11	5	Healthcare Information Technology	MBA – (Northwestern University – Kellogg) BS – Applied and Biomedical Sciences (Pennsylvania)