

Viewpoint

Baird Investment Management (BIM) manages high-quality portfolios for high-net-worth individuals and institutional clients.

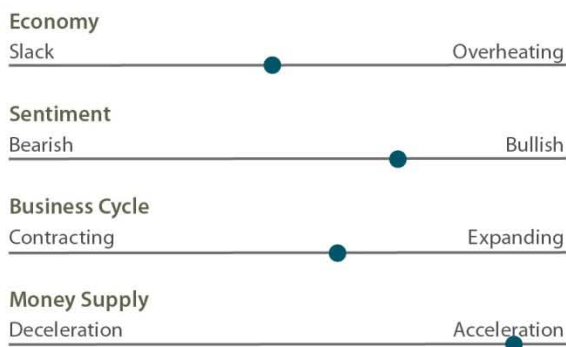
BAIRD

Baird Investment Management

“This is like déjà vu all over again.”

- Yogi Berra

Market barometer



Source: MTI, Investors Intelligence, Bloomberg

Market update

as of 10/31/11

	MTD	YTD	Trailing 12 Months
Dow Industrial Average	9.7%	5.5%	10.4%
S&P 500	10.9%	1.3%	8.1%
Russell 1000® Growth	11.0%	3.0%	9.9%
Russell MidCap® Growth	13.5%	0.3%	10.1%

Source: Russell, APL

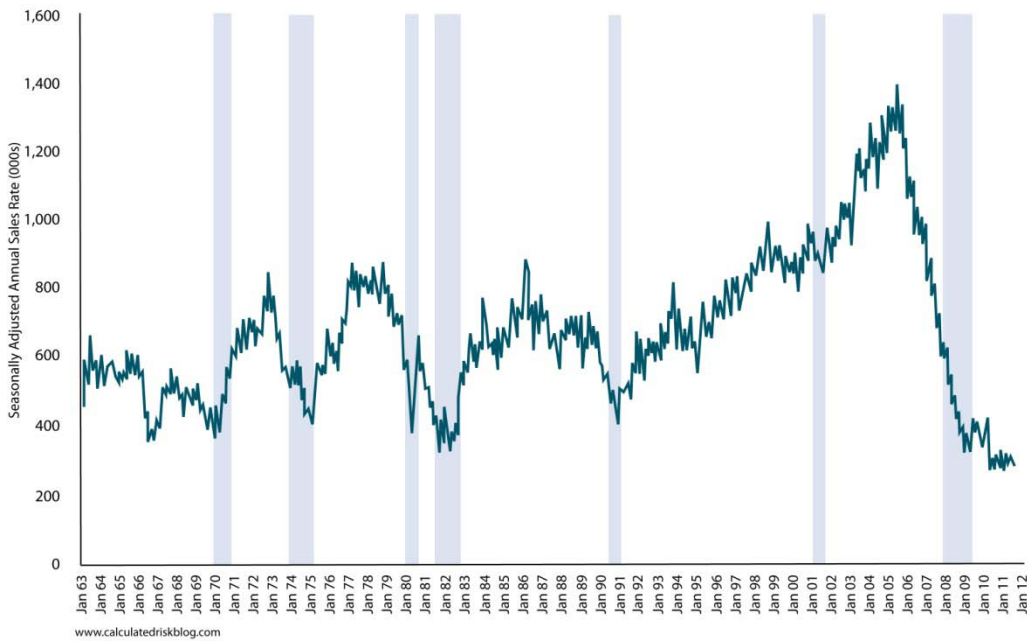
Revisiting Housing

Nothing is more central to the problems facing this country than the condition of our housing market. Back in our June 2009 Viewpoint titled “Beginning of the End?” we suggested that many of the elements were in place for the housing market to stabilize. While house prices have exhibited a bottoming pattern in recent years, overall housing activity is a far cry from the economic growth engine that it had been in post-WWII economic times. We continue to watch for signs of further stabilization, which we feel will eventually lead to growth.

History

New home starts peaked in 2005 at greater than two million units, roughly double the then-lowest level of new home starts in 1991. Given that new home sales normally surge after a recession (see Table 1 on next page), history would suggest that new home starts should not only have stabilized but grown since the summer of 2009. On the contrary, 2011 is on pace to be the third year in a row of less than 600 thousand starts. This lack of activity has been one of the root causes of the country’s unemployment problem. Many of the construction workers employed during the housing boom have a different set of skills than those required for today’s job market.

Table 1: New Home Sales and Recessions



Policy Attempts

Since the height of the financial crisis, multiple government programs allocating billions of dollars have been introduced to jump start the housing market. To date, the benefit of these efforts is debatable, as positive outcomes have proved temporary and lacking any meaningful impact. Many of these programs have been difficult to administer and reached far fewer borrowers than projected, which we see as a function of competing interests between homeowners, politicians, banks and mortgage investors. In our view, some of the attempts to stall the foreclosure process may have been detrimental as they restricted a natural clearing of the market. The most recent government proposal is a reworking of the Home Affordable Refinancing Program (HARP) that would allow certain mortgage holders who are current on their payments to refinance even if they have negative equity. There has also been speculation that the Federal Reserve may resume buying mortgages in order to drive interest rates lower. Based on recent history, the expectations for any one program should be low.

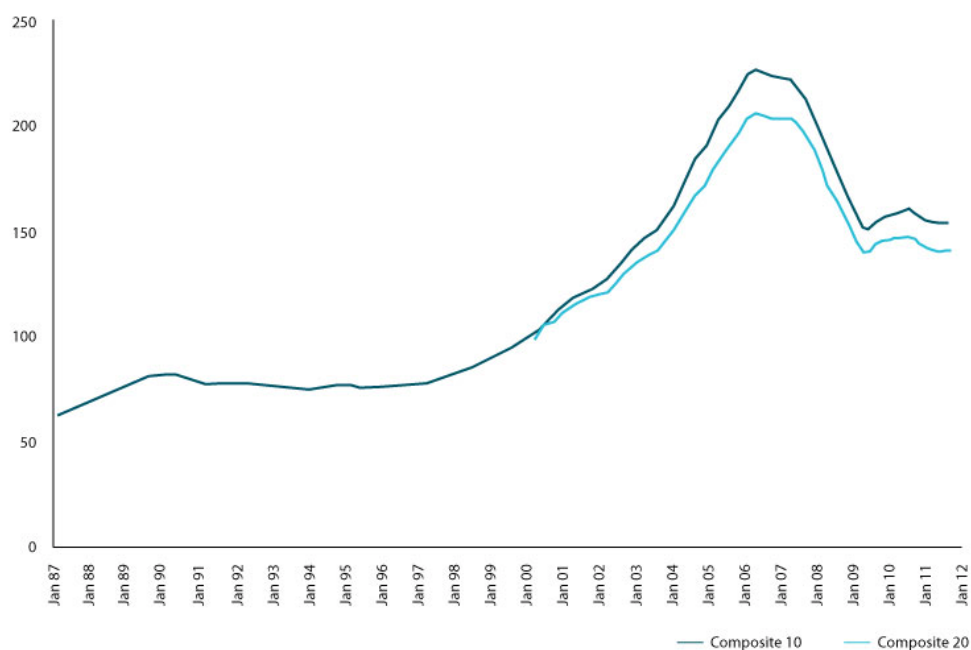
Table 2: 30 Year Mortgage Rates from Freddie Mac’s Primary Mortgage Market Survey



Outlook

The combination of historically low mortgage rates (see Table 2) and a reduction in the price of most homes in the United States has pushed housing affordability to near all-time highs. However, home prices remain in a bottoming process, as shown by the Case-Shiller Composite Indices (see Table 3), and housing activity continues to be depressed. This relationship suggests to us that the solution to the housing problem is tied to fundamental economic growth and job creation. Employment, income growth and consumer confidence are the factors that provide a foundation for a healthy housing market. While it may be appropriate to treat symptoms with targeted programs, efforts to attack the disease (lack of housing demand) are required. We feel acrimony in Washington, D.C., and 9% unemployment are roadblocks to a strong housing market. Although the worst of the decline in home prices is likely behind us, every market must find its own bottom. It is our view that housing will not be a major contributor to GDP growth for a few years as we work off the country's excess inventory. The best odds of correcting the housing drag are found in promoting policies that lead to economic and job growth, which can expand the demand for houses and the supply of mortgage credit.

Table 3: Case-Shiller Composite Indices SA (Nominal)



Source: www.calculatedriskblog.com

To learn more about Baird Investment Management (BIM) and our products, please contact us at 800-792-4100 or 414-765-7246. Visit us online at bairdinvestmentmanagement.com.

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The S&P 500 Index is a representative sample of 500 leading companies in leading industries of the U.S. economy. The Russell 1000® Growth Index measures the performance of those Russell 1000® companies with higher price-to-book ratios and higher forecasted growth values and is a large-cap index. The Russell Midcap® Growth Index measures the performance of those Russell Midcap companies with higher price-to-book and higher forecasted growth values. The stocks are also members of the Russell 1000® Index. The Dow Jones Composite Average Index is computed from the stock prices of 30 of the largest and most widely held public companies in the United States.

The Standard & Poor's Case-Shiller Home Price Indices are constant-quality house price indices for the United States. There are multiple Case-Shiller home price indices: A national home price index, a 20-city composite index, a 10-city composite index, and twenty individual metro area indices.

The composite 10 index is a composite index of the home price index for 10 major Metropolitan Statistical Areas in the United States.

The composite 20 index is a composite index of the home price index for 20 major Metropolitan Statistical Areas in the United States.

Indices are unmanaged, and an investment cannot be made in one. Past performance is not a guarantee of future results.

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