

Viewpoint

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

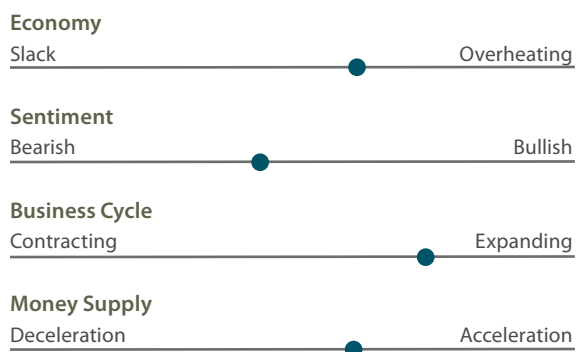
BAIRD

Baird Investment Management

“Any fool can make things bigger, more complex, and more violent. It takes a touch of genius – and a lot of courage – to move in the opposite direction.”

— Albert Einstein

Market barometer



Source: MTI, Investors Intelligence, Bloomberg

Market update

as of 6/30/11

	MTD	YTD	Trailing 12 Months
Dow Industrial Average	-1.1%	8.6%	30.4%
S&P 500	-1.7%	6.0%	30.7%
Russell 1000® Growth	-1.4%	6.8%	35.0%
Russell MidCap® Growth	-1.6%	9.6%	43.3%

Source: Russell, APL

As investors grapple with negative headlines, we work to separate the noise from reality. Our outlook is for continued economic recovery – even one characterized by more moderate growth. Below we offer a few considerations as to why the slower growth rate of recent months may well stabilize and improve in the second half of the year.

Justified economic concerns

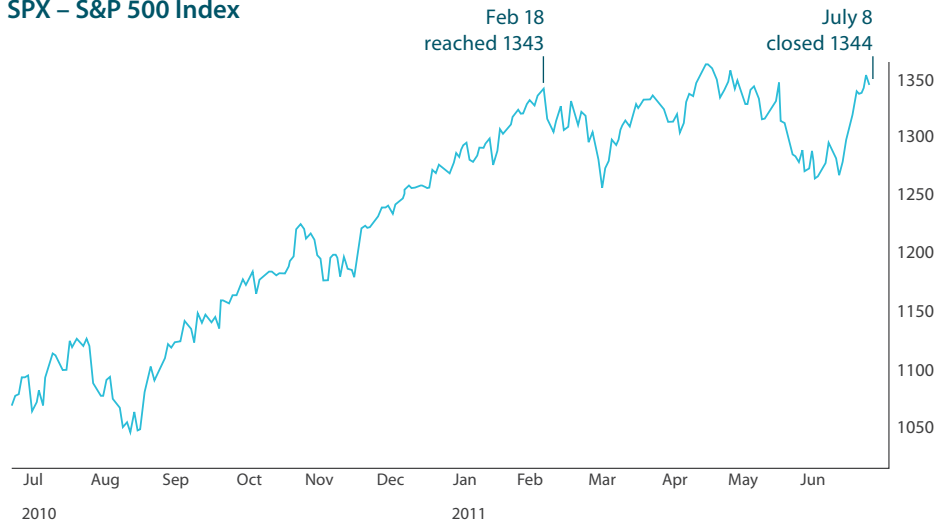
It is reasonable for investors to be concerned with the potential for economic contraction, considering the slowing GDP and the long list of macro headwinds today – significant multi-year deleveraging, persistent unemployment, weak housing prices, natural disasters, political unrest, European debt crisis, the slowing of economic growth in Asia and U.S. political uncertainty over the debt ceiling. These factors, as well as the end of the Fed’s QE2 program, are causing investor angst, as evidenced by the flat performance and increased volatility of the S&P 500 since last February (see chart on next page).

We remain optimistic

Despite these challenges, we expect continued modest growth for the remainder of this year with a potential pick up in 2012, and we have positioned our portfolios to benefit from this expectation. It is worth noting that a mid-cycle slowdown is typical, having occurred six times in the past 30 years. This slowdown is entering its fourth month, putting it in line with the 4.3 month average length of previous slowdowns.

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SPX – S&P 500 Index



Source: Bloomberg Finance L.P.

While the factors accounting for economic concern are justified, our view is that many are not incrementally new. Most seem to be stable, and a few are showing modest signs of progress in the past six to 18 months. The following overview of the key concerns highlighted above provides the basis for our relatively optimistic economic stance.

With respect to deleveraging, personal savings began to increase in late 2007, peaking in May 2009. Over the past two years, the rate of savings has been relatively consistent. To us, this suggests that consumer deleveraging will not act as an incremental drag and has become more orderly. Unemployment, while high and uneven, is down from its October 2009 peak of 10.1%. Recent data from the U.S. Bureau of Labor points out that the unemployment rate for college-educated adults aged 25–34 is 4.9%, versus 13.7% for those with only a GED. (Parents, keep those kids in school!) Those who have jobs are well-paid and appear to be willing to spend. Corporations are seeing less and less slack, as capacity utilization has increased to 77% from the trough of 67% in May 2009.

Housing looks to be in the process of bottoming, as evidenced by the most recent Case Shiller data ticking up slightly in April to 139 from 138 in March. The index previously bottomed out at 139 in April 2009. Importantly, we believe most of the weakness is due to the continued softness in the foreclosure market, which has been hampered by government and legal intervention. We expect these market-clearing impediments to begin to be resolved, allowing for a more orderly resolution. In Europe, the market seems to have already accounted for a Greek default, and we expect continued progress in reaching debt agreements, particularly with austerity programs beginning to take hold.

Disruptions from the Japanese earthquake and tsunami and from Middle East unrest are abating as the supply chain has adjusted to these events. In addition, corporate profitability has remained high, with companies in the S&P 500 having nearly \$1 trillion in cash on hand. We expect these factors will allow more corporate investing over the intermediate term.

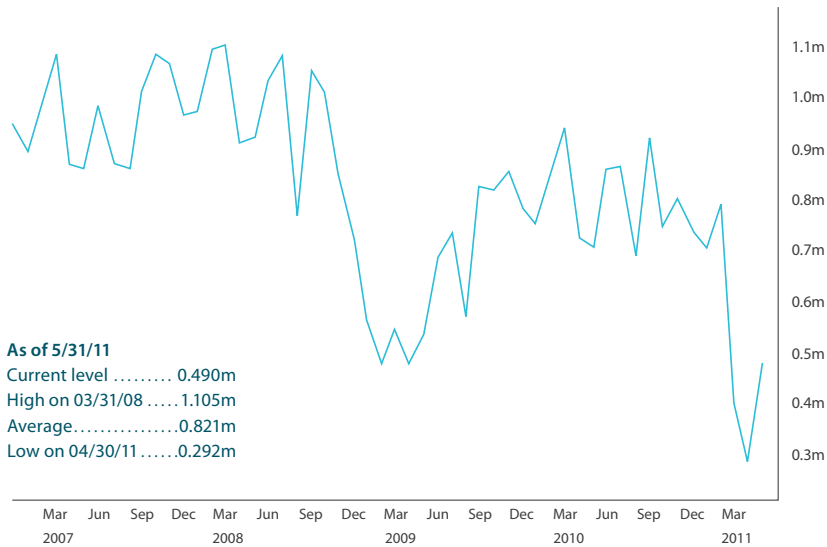
Manufacturing strength in the automotive sector

Importantly, we see opportunity for continued improvement in manufacturing, which is partially supported by the ISM numbers that remain well above 50 this year (55 at last report). One important area in which we are particularly encouraged is the automotive sector, where we expect to see improvement in the second half of the year. Vehicle production schedules in the United States, hampered by parts shortages and assembly shutdowns resulting from the earthquake in Japan, are recovering though not yet evident in reported production data (see the two charts on the next page). However, Japanese vehicle production is already in the midst of a sharp recovery. Improvement in U.S. vehicle production should lift domestic GDP and employment for at least the next two quarters. Additionally, the necessary

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rebuilding of infrastructure and businesses in Japan should help sustain the strong industrial trends of the past several years. Other market segments, such as oil field equipment, heavy duty truck and some components of consumer discretionary, still offer good visibility to improving margins and attractive earnings growth.

Japan vehicle production



U.S. vehicle production (SAAR)



Source: Bloomberg Finance L.P.

To learn more about Baird Investment Management (BIM) and our products, please contact us at 800-792-4011 or 414-765-7246. Visit us online at bairdinvestmentmanagement.com.

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Securities should not be purchased solely based on the dividend rate.

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

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