

Q1 2010 Asset Flow Analysis

Baird Private Wealth Management

Wealth Management | **Capital Markets – Investment Banking** | **Private Equity** | **Asset Management**

Chicago Frankfurt London Milwaukee Shanghai

Summary of Observations

Asset Flows

- Given the exponential growth of the ETF market, it is necessary to consider both mutual fund and ETF flows to determine how assets are being invested or transferred. For example, 2008 mutual fund flows were \$97B out of U.S. Stock funds; however combined fund and ETF flows were positive \$16B. More recently, Q1 fund flows into U.S. Stocks were modestly positive, but fund and ETF flow was negative \$3B.
- In Q1 the mutual fund and ETF market experienced its biggest net negative quarter over the past 10 years (i.e., money taken out of the market altogether), to the tune of -\$192B. Net negative periods are fairly uncommon and Q1's outflow dwarfs past occurrences. Previously, the largest quarterly market outflows in the last decade were -\$97B in 2Q03 and -\$33B in 1Q03. In fact, Q1 outflow was more than \$20B greater than all other recorded occurrences combined.
- These net negative periods could be a result of investor's taking money out of the system to pay down debt levels or to place in more traditional savings and checking accounts. Typically, these periods accompany the troughs of an economic cycle. Since the stock market cycle moves ahead of the economic cycle, these outflows tend to occur when the market is experiencing an upswing.
- Recently, the two broader areas benefiting most from inflows have stark differences: short-term fixed income and more aggressive areas (emerging markets, commodities, etc.). Short-term fixed income is generally considered very conservative and inflows could be seen as a need to earn more income than currently provided in money market accounts. Inflows to more aggressive areas could be seen as an increased risk appetite for some investors or ways to diversify U.S. stock exposure.

Asset Allocation

- Point in time analysis of asset allocation is difficult, but it appears that compared to 10 years ago a smaller proportion of assets are invested in U.S. stocks (64% vs. 45%). Beneficiaries of this shift include International stocks and Fixed Income. Baird believes there is secular trend back towards holding higher levels of fixed income. Additionally, international markets have become much easier to access (as mutual fund and ETF choices have grown) and provide non-U.S. diversification.

Active vs. Passive Investing

- Passively managed options have witnessed a steady increase usage (40 straight quarters of net inflows), while flows tied to active management have been more volatile.
- Outflows from active managers have occurred for the past four quarters, including a Q1 outflow that is the biggest on record. Perhaps not coincidentally the last major period of active management outflows occurred during the 2003 rally after the 2000-02 downturn.
- Investors still tend to prefer active strategies for fixed income investing and a blended approach for equities. Interestingly, ETFs are the preferred method of gaining access to commodities despite evidence that active management is able to add value in this area with relative ease. However, commodity investments tend to be more targeted to a specific resource (e.g., gold, oil, etc.)

Asset Flows (as of 3/31/10)

Annual Mutual Fund Flows (\$millions)

	Total Asset Class Size	YTD 2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000
Money Market	\$2,870,343	(324,362)	(378,690)	596,901	393,767	225,938	117,325	(119,159)	(375,359)	(35,664)	369,454	151,373
Municipal Bond	\$481,069	14,002	72,235	7,850	16,641	21,045	8,850	(8,418)	(4,682)	15,060	6,825	(12,850)
Taxable Bond	\$1,645,822	74,537	287,562	27,468	103,545	62,031	28,768	14,827	47,762	112,791	64,581	(23,792)
Balanced	\$671,185	6,123	(2,927)	(23,644)	43,873	28,922	48,935	58,128	45,239	20,348	12,185	(26,383)
U.S. Stock	\$3,208,760	245	(25,889)	(95,602)	(2,662)	55,258	62,270	116,329	133,162	27,320	81,476	167,040
International Stock	\$1,204,672	19,724	24,466	(71,274)	143,169	138,604	104,183	62,553	31,344	9,770	(11,915)	34,445
Alternative	\$63,494	6,120	14,266	3,938	3,126	6,297	1,770	5,583	4,542	2,562	721	349
Commodities	\$25,797	3,091	10,224	(701)	(1,872)	811	4,983	4,829	1,417	105	(22)	(4)

Annual Mutual Fund & ETF Flows (\$millions)

	Total Asset Class Size	YTD 2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000
Money Market	2,870,343	(324,362)	(378,690)	596,901	393,767	225,938	117,325	(119,159)	(375,359)	(35,664)	369,454	151,300
Municipal Bond	487,736	14,582	75,621	9,432	16,711	21,045	8,850	(8,418)	(4,682)	15,060	6,825	(12,850)
Taxable Bond	1,749,849	82,759	322,881	44,470	114,311	66,968	34,994	18,342	48,208	113,386	64,581	(23,793)
Balanced	671,575	6,195	(2,737)	(23,615)	43,878	28,922	48,935	58,128	45,239	20,348	12,185	(26,275)
U.S. Stock	3,613,133	(2,696)	(40,380)	15,678	70,294	76,147	82,730	148,988	140,327	63,421	100,911	181,516
International Stock	1,400,155	20,014	52,999	(58,244)	183,479	163,410	126,160	77,384	36,893	13,247	(10,963)	34,655
Alternative	96,361	8,547	38,477	4,816	10,817	9,085	1,770	5,583	4,542	2,562	721	349
Commodities	97,089	2,068	36,732	12,079	5,943	8,429	7,780	4,706	1,417	105	(22)	(4)

Analysis

Incorporating ETF flows is becoming increasingly important when gauging the direction of asset flows. Additionally, the perception changes when including a broader data set. For example, flows were decidedly negative for US Stock mutual funds in 2008. However, when ETFs are included, the flows were actually positive.

The broader data set also shows that flows in Q1 2010 are negative for US Stocks, whereas fund flows are marginally positive.

Historical Flows as a Percent of Category Assets

ANNUAL FLOWS (as a % of previous year's assets)									
2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
U.S. Mid Cap 24.1%	Money Market 26.1%	Commodities 656.3%	Commodities 551.4%	Commodities 335.4%	Commodities 92.0%	Commodities 45.0%	Alternative 30.1%	Commodities 27.8%	Commodities 83.9%
U.S. Small Cap 15.2%	U.S. Small Cap 18.3%	Alternative 43.6%	Emerging Markets 52.5%	Alternative 35.7%	Emerging Markets 44.0%	Alternative 38.0%	Emerging Markets 24.7%	Money Market 26.0%	Alternative 70.4%
Money Market 12.9%	Taxable Bonds 15.9%	Taxable Bonds 22.7%	Alternative 46.2%	Emerging Markets 26.0%	Developed International 19.0%	Emerging Markets 23.0%	Money Market 21.2%	Alternative 9.0%	Emerging Markets 38.3%
Developed International 10.1%	Alternative 14.5%	Emerging Markets 15.2%	U.S. Small Cap 18.1%	Developed International 17.7%	Alternative 8.8%	Developed International 19.5%	Commodities 20.7%	Taxable Bonds 3.9%	Taxable Bonds 28.9%
Alternative 7.8%	U.S. Mid Cap 11.0%	U.S. Small Cap 13.1%	U.S. Mid Cap 16.9%	U.S. Small Cap 11.5%	Money Market 8.2%	Money Market 14.0%	Developed International 12.7%	Municipal Bonds 2.6%	Municipal Bonds 22.4%
U.S. Large Cap 4.2%	U.S. Large Cap 3.6%	U.S. Mid Cap 11.6%	Developed International 14.2%	U.S. Mid Cap 11.3%	U.S. Mid Cap 6.3%	Taxable Bonds 7.9%	Taxable Bonds 12.0%	U.S. Large Cap 0.6%	U.S. Small Cap 3.1%
Emerging Markets 1.0%	Municipal Bonds 3.0%	Developed International 7.8%	Taxable Bonds 7.5%	U.S. Large Cap 4.8%	Taxable Bonds 4.4%	Municipal Bonds 6.9%	Municipal Bonds 5.0%	Emerging Markets -0.3%	Developed International 2.6%
Commodities -3.1%	Developed International -0.2%	Municipal Bonds 6.0%	U.S. Large Cap 6.0%	Taxable Bonds 2.5%	U.S. Small Cap 3.7%	U.S. Small Cap 4.9%	U.S. Mid Cap 2.8%	U.S. Small Cap -0.9%	U.S. Mid Cap 0.8%
Municipal Bonds -5.8%	Emerging Markets -1.4%	U.S. Large Cap 1.8%	Municipal Bonds -1.7%	Municipal Bonds -2.9%	Municipal Bonds 3.1%	U.S. Large Cap 2.4%	U.S. Large Cap 2.3%	Developed International -3.2%	U.S. Large Cap -3.5%
Taxable Bonds -5.8%	Commodities -80.0%	Money Market -1.9%	Money Market -19.7%	Money Market -8.2%	U.S. Large Cap 1.9%	U.S. Mid Cap 0.7%	U.S. Small Cap -2.9%	U.S. Mid Cap -5.2%	Money Market -11.1%

QUARTERLY FLOWS (as a % of previous quarter's assets)			
Q2 2009	Q3 2009	Q4 2009	Q1 2010
Alternative 24.5%	Alternative 9.2%	Alternative 11.7%	Alternative 9.3%
Emerging Markets 15.7%	Taxable Bonds 7.6%	Commodities 10.2%	Taxable Bonds 5.1%
Commodities 13.0%	Municipal Bonds 7.3%	Taxable Bonds 6.2%	Municipal Bonds 3.1%
Taxable Bonds 6.6%	Commodities 5.6%	Emerging Markets 6.1%	Developed International 2.1%
Municipal Bonds 5.1%	Emerging Markets 5.3%	Municipal Bonds 3.5%	Commodities 2.1%
U.S. Small Cap 2.4%	U.S. Small Cap 2.8%	Developed International 1.9%	U.S. Small Cap 1.2%
U.S. Mid Cap 1.9%	Developed International 2.0%	U.S. Mid Cap -0.4%	U.S. Mid Cap 1.1%
Developed International 0.8%	U.S. Mid Cap 1.1%	U.S. Large Cap -0.4%	Emerging Markets 0.9%
U.S. Large Cap 0.1%	U.S. Large Cap -0.6%	U.S. Small Cap -1.0%	U.S. Large Cap -0.7%
Money Market -3.6%	Money Market -5.4%	Money Market -3.0%	Money Market -10.2%

	ANNUAL TOTAL CATEGORY ASSETS (\$millions)									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Money Market	\$1,416,464	\$1,907,024	\$1,904,198	\$1,448,345	\$1,439,525	\$1,608,948	\$1,860,790	\$2,294,488	\$3,418,920	\$3,193,778
Municipal Bond	\$228,660	\$251,535	\$283,144	\$288,625	\$286,445	\$303,078	\$336,411	\$363,022	\$337,733	\$467,608
Taxable Bond	\$406,648	\$499,019	\$646,409	\$742,474	\$791,335	\$845,612	\$954,437	\$1,146,961	\$1,115,701	\$1,624,839
U.S. Large Cap	\$1,711,605	\$1,577,304	\$1,296,259	\$1,751,038	\$2,027,781	\$2,213,762	\$2,654,260	\$3,031,070	\$1,890,662	\$2,396,662
U.S. Mid Cap	\$209,688	\$198,860	\$183,781	\$287,259	\$371,132	\$432,970	\$496,099	\$554,152	\$305,812	\$432,274
U.S. Small Cap	\$114,624	\$137,267	\$124,955	\$202,526	\$267,021	\$297,786	\$358,320	\$362,636	\$232,234	\$320,230
Developed Int'l	\$208,554	\$175,078	\$161,143	\$260,379	\$347,022	\$476,088	\$745,574	\$969,833	\$520,069	\$717,914
Emerging Markets	\$18,066	\$15,743	\$16,967	\$37,298	\$58,370	\$104,405	\$165,917	\$287,449	\$133,411	\$294,380
Alternative	\$4,969	\$5,877	\$9,837	\$15,630	\$20,209	\$23,929	\$35,891	\$53,482	\$54,685	\$91,942
Commodities	\$22	\$16	\$257	\$1,403	\$8,459	\$18,746	\$28,722	\$43,493	\$43,789	\$96,951

	QUARTERLY TOTAL CATEGORY ASSETS (\$millions)			
	Q2 2009	Q3 2009	Q4 2009	Q1 2010
Money Market	\$3,456,010	\$3,287,142	\$3,193,778	\$2,870,343
Municipal Bond	\$395,429	\$456,191	\$467,608	\$487,736
Taxable Bond	\$1,324,390	\$1,511,219	\$1,624,839	\$1,749,849
U.S. Large Cap	\$1,957,519	\$2,264,616	\$2,396,662	\$2,513,739
U.S. Mid Cap	\$338,526	\$411,440	\$432,254	\$471,203
U.S. Small Cap	\$251,933	\$308,367	\$320,230	\$350,699
Developed Int'l	\$564,198	\$689,928	\$717,914	\$752,956
Emerging Markets	\$203,991	\$256,754	\$294,380	\$303,984
Alternative	\$76,258	\$81,637	\$91,942	\$96,361
Commodities	\$73,087	\$80,881	\$96,951	\$97,089

Source: Morningstar Direct, Baird Research. Categories are as defined by Morningstar. Money market, Municipal bonds, Taxable bonds, Alternative and Commodities are broad asset classes defined and constructed by Morningstar. U.S. Large Cap is a combination of Large Value, Large Blend and Large Growth categories, U.S. Mid Cap is a combination of Mid Value, Mid Blend and Mid Growth categories. U.S. Small Cap is a combination of Small Value, Small Blend and Small Growth categories. Developed International is a combination of Foreign Large Value, Foreign Large Blend and Foreign Large Growth Categories. Emerging Markets is a combination of Diversified Emerging Markets, Latin America and Pacific/Asia ex. Japan.

Asset Flows (Mutual Funds and ETFs)

Leaders and Laggards by Category – Q1 2010

Top 15 % Leaders (as a % of assets)	Trailing 1-Yr Change (%)	Market Share (%)	Top 15 % Laggards (as a % of assets)	Trailing 1-Yr Change (%)	Market Share (%)
Bear Market	134%	0.23	Financial	-37%	0.19
Commodities Broad Basket	119%	0.32	Money Market Tax Free	-24%	3.38
Ultrashort Bond	91%	0.31	Money Market Taxable	-20%	22.74
Muni National Short	91%	0.75	Health	-6%	0.44
World Bond	72%	1.04	Large Value	-4%	5.19
Short-Term Bond	71%	1.56	Moderate Allocation	-3%	3.46
Emerging Markets Bond	60%	0.24	Large Growth	-3%	7.48
Long-Short	54%	0.35	World Stock	-1%	2.51
Inflation-Protected Bond	51%	0.89	Muni California Long	-1%	0.33
Pacific/Asia ex-Japan Stk	48%	0.54	Intermediate Government	-1%	1.14
Natural Res	40%	0.40	Large Blend	-1%	10.10
Bank Loan	35%	0.28	Mid-Cap Value	1%	0.96
Diversified Emerging Mkts	35%	1.98	Mid-Cap Growth	1%	1.66
Latin America Stock	35%	0.24	Muni New York Long	2%	0.27
High Yield Muni	27%	0.47	Foreign Large Value	4%	1.42

Top 15 \$ Leaders	Trailing 1-Yr Change (\$M)	Market Share (%)	Top 15 \$ Laggards	Trailing 1-Yr Change (\$M)	Market Share (%)
Intermediate-Term Bond	138,774	7.01	Money Market Taxable	(625,235)	22.74
Short-Term Bond	66,748	1.56	Money Market Tax Free	(114,398)	3.38
World Bond	42,804	1.04	Large Growth	(17,797)	7.48
Muni National Short	37,957	0.75	Large Value	(14,248)	5.19
Diversified Emerging Mkts	34,202	1.98	Moderate Allocation	(9,099)	3.46
Inflation-Protected Bond	30,235	0.89	Financial	(5,322)	0.19
Foreign Large Blend	27,052	3.90	Large Blend	(4,565)	10.10
Bear Market	23,146	0.23	World Stock	(2,710)	2.51
High Yield Bond	19,278	1.58	Health	(2,206)	0.44
Muni National Interm	17,804	0.91	Intermediate Government	(1,144)	1.14
World Allocation	16,642	1.68	Muni California Long	(405)	0.33
Commodities Broad Basket	16,350	0.32	Mid-Cap Value	488	0.96
Ultrashort Bond	15,690	0.31	Muni New York Long	504	0.27
Multisector Bond	13,742	1.02	Muni Single State Interm	713	0.14
Long-Short	13,179	0.35	Utilities	1,228	0.16

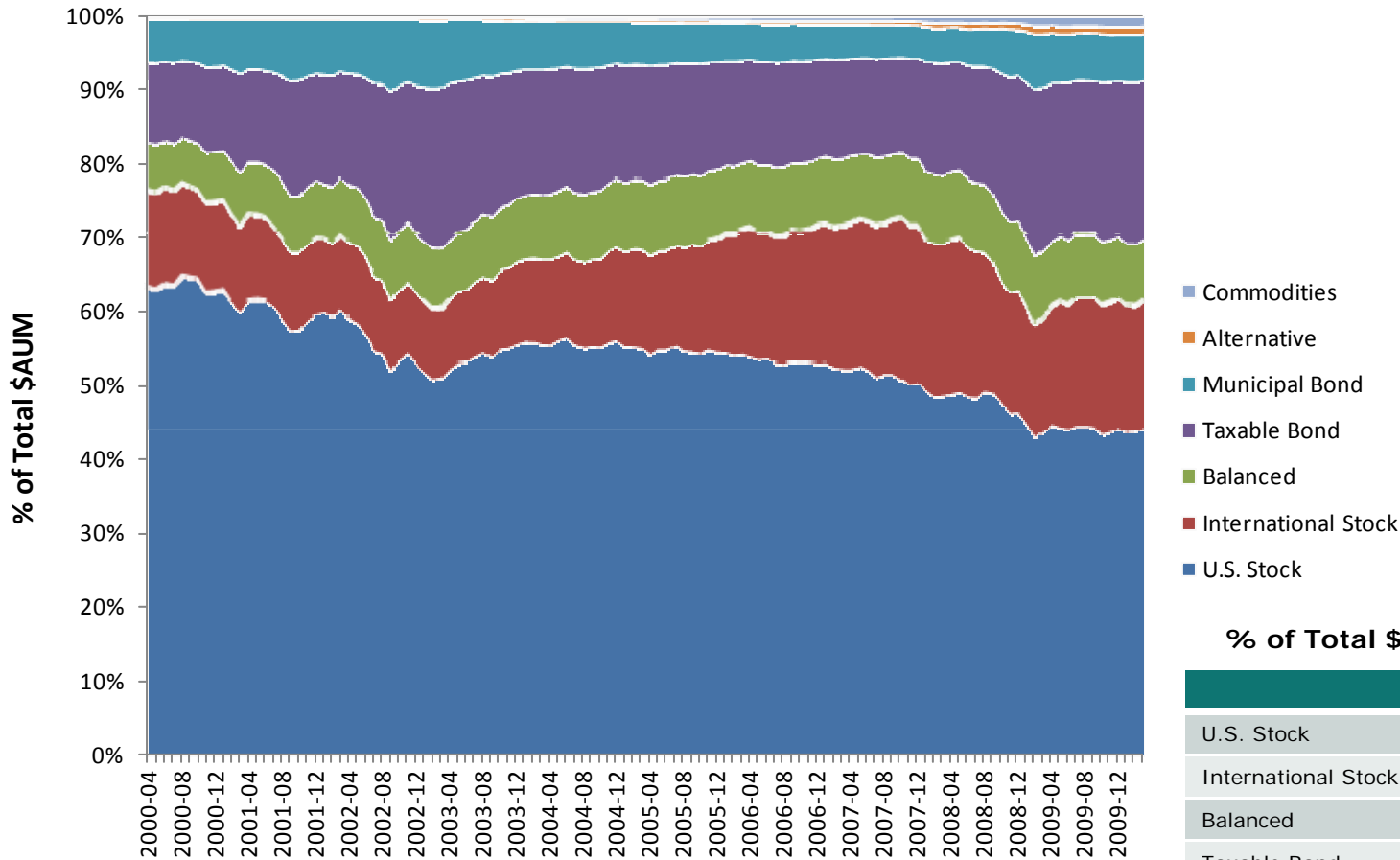
Analysis

Inflows have been focused on the dichotomy of primarily short-term fixed income funds and more speculative equity funds (commodities, Asia, etc.)

Outflows have been strong in money market funds and somewhat more muted in traditional equity asset classes.

Shifts in Assets over Time

Historical Asset Allocation (including mutual funds & ETFs, excluding money market funds)



Analysis

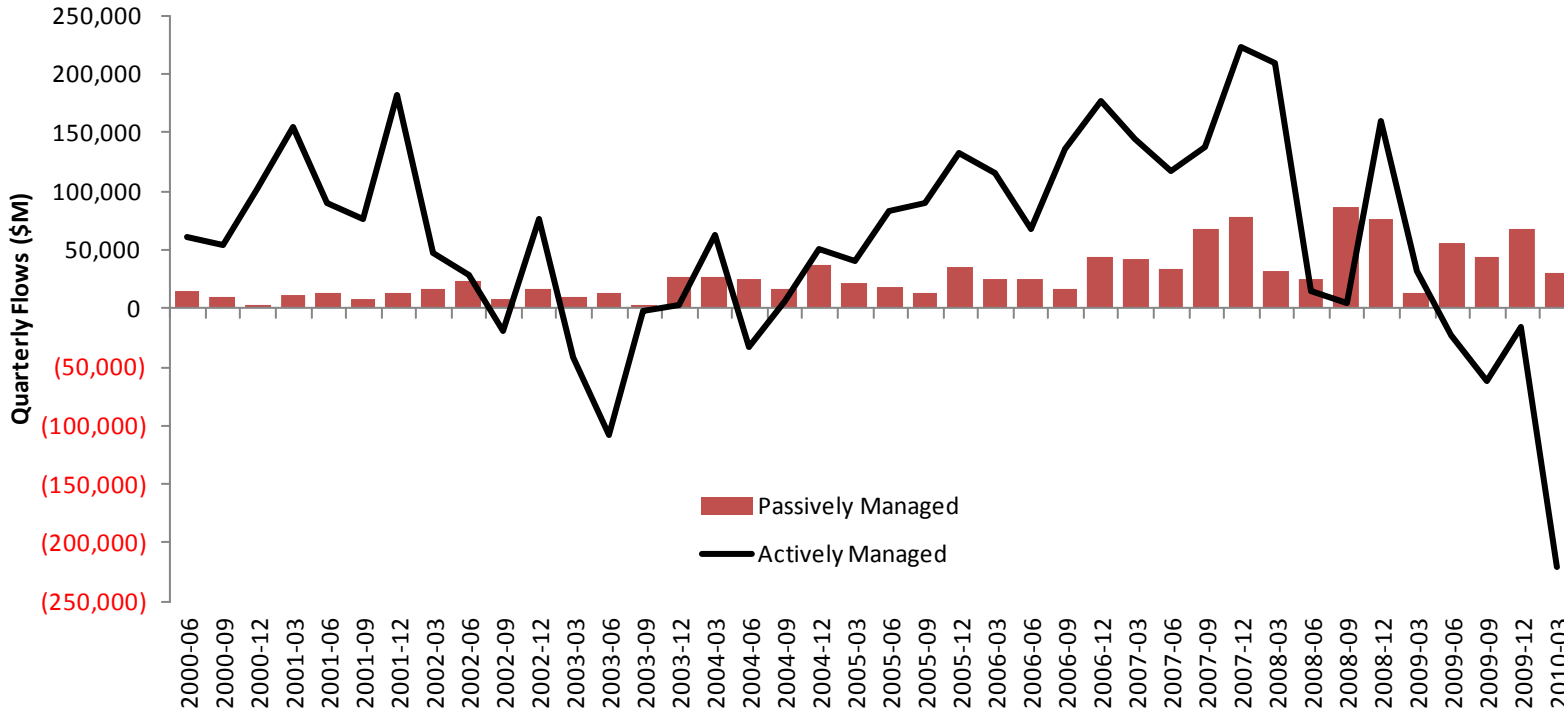
Some shifts in asset allocation are certainly in response to market events, others represent thematic changes. The stock/bond allocation may be due to market events, so no inferences can clearly be made. The increase in International weighting, as well as Alternative and Commodities may represent a broader shift in asset allocation.

% of Total \$AUM (Current vs. 10 Years Ago)

	Q1 2000	Q1 2010
U.S. Stock	63.5%	44.5%
International Stock	13.0%	17.3%
Balanced	6.5%	8.3%
Taxable Bond	10.9%	21.6%
Municipal Bond	5.9%	6.0%
Alternative	0.1%	1.2%
Commodities	0.0%	1.2%

Active vs. Passive (Estimated Net Flows)

Quarterly Flows for Active & Passive Investments (mutual funds & ETFs)

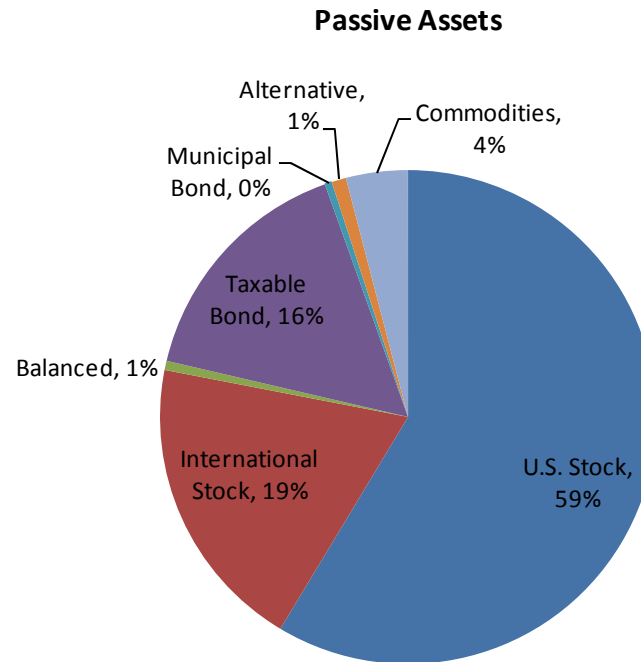
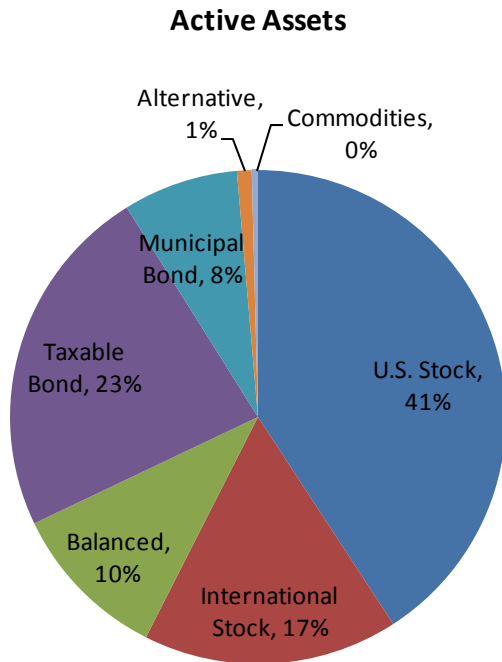


Analysis

This chart analyzes the quarterly flows into and out of active and passive investments. Flows of active management styles tends to be more volatile, including a recent spike in outflows. Flows for passive investments appears to be stable and growing over time. In fact, over the past 10 years there have not been any quarterly outflows.

Implementation of Active vs. Passive Investments

% of \$AUM by Category (Active versus Passive Investments)



Analysis

Some areas of the market are more efficient than others. For example, US large cap is generally an efficient market whereas emerging markets are less efficient. In areas that are efficient, passive strategies work well (and vice versa).

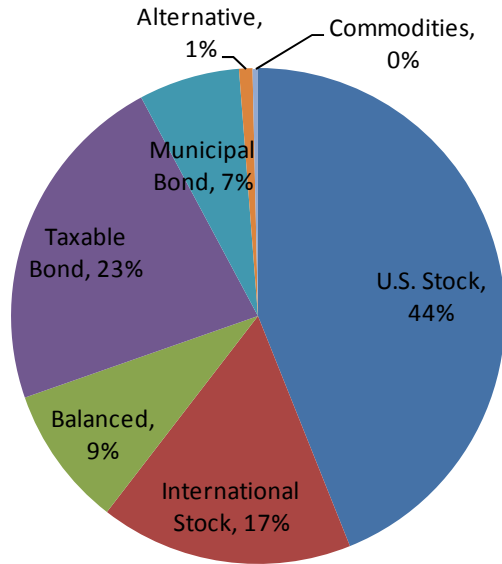
Contrasting where investors use active/passive strategies allows us to get a sense whether investors are optimizing their portfolios. For example, active management generally adds value in commodities, yet more focus has been paid to passive ETFs.

Data as of 3/31/10

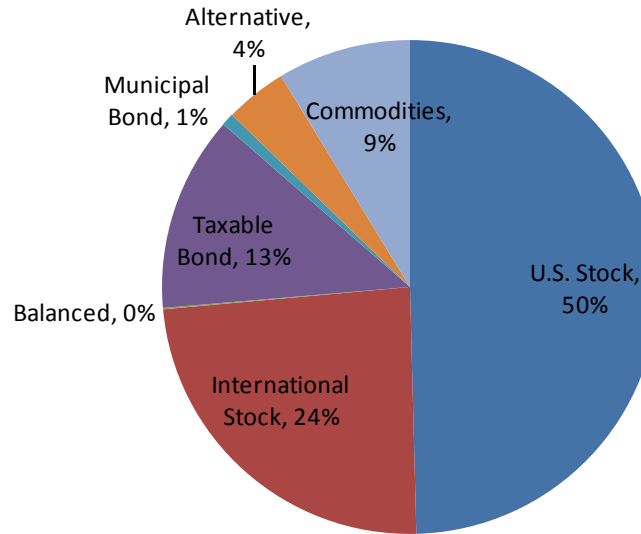
Usage of Mutual Funds vs. ETFs

% of \$AUM by Category (Mutual Funds versus ETFs)

Mutual Fund Assets



ETF Assets



Analysis

This analysis contrasts which categories investors favor for various asset classes. For example, commodities appears to be accessed via the ETF market much more frequently than mutual funds. Alternatively, investors have favored mutual fund in fixed income.

Data as of 3/31/10

Passive Investment Asset Flows

Leaders and Laggards by Category

Top 15 % Leaders (as a % of assets)	Trailing 1-Yr Change (%)	Market Share (%)	Top 15 % Laggards (as a % of assets)	Trailing 1-Yr Change (%)	Market Share (%)
Emerging Markets Bond	559%	0.10	Diversified Pacific/Asia	-30%	0.40
Long-Short	316%	0.07	Financial	-9%	0.68
Foreign Small/Mid Growth	257%	0.08	Consumer Staples	0%	0.24
Miscellaneous Sector	178%	0.56	Large Growth	0%	3.45
High Yield Bond	138%	0.56	Health	1%	0.51
Commodities Broad Basket	119%	0.56	Moderate Allocation	2%	0.54
Consumer Discretionary	114%	0.21	Large Value	3%	3.33
Muni National Short	111%	0.21	Large Blend	3%	34.47
Short-Term Bond	94%	1.44	Commodities Precious Metals	5%	2.90
Natural Res	90%	0.69	Foreign Large Growth	6%	0.08
Inflation-Protected Bond	84%	1.37	Japan Stock	6%	0.38
World Stock	79%	0.21	Long-Term Bond	7%	0.89
Muni National Long	69%	0.20	Small Value	11%	1.40
Technology	69%	0.61	Foreign Small/Mid Value	12%	0.80
Industrials	62%	0.42	Mid-Cap Blend	15%	4.73

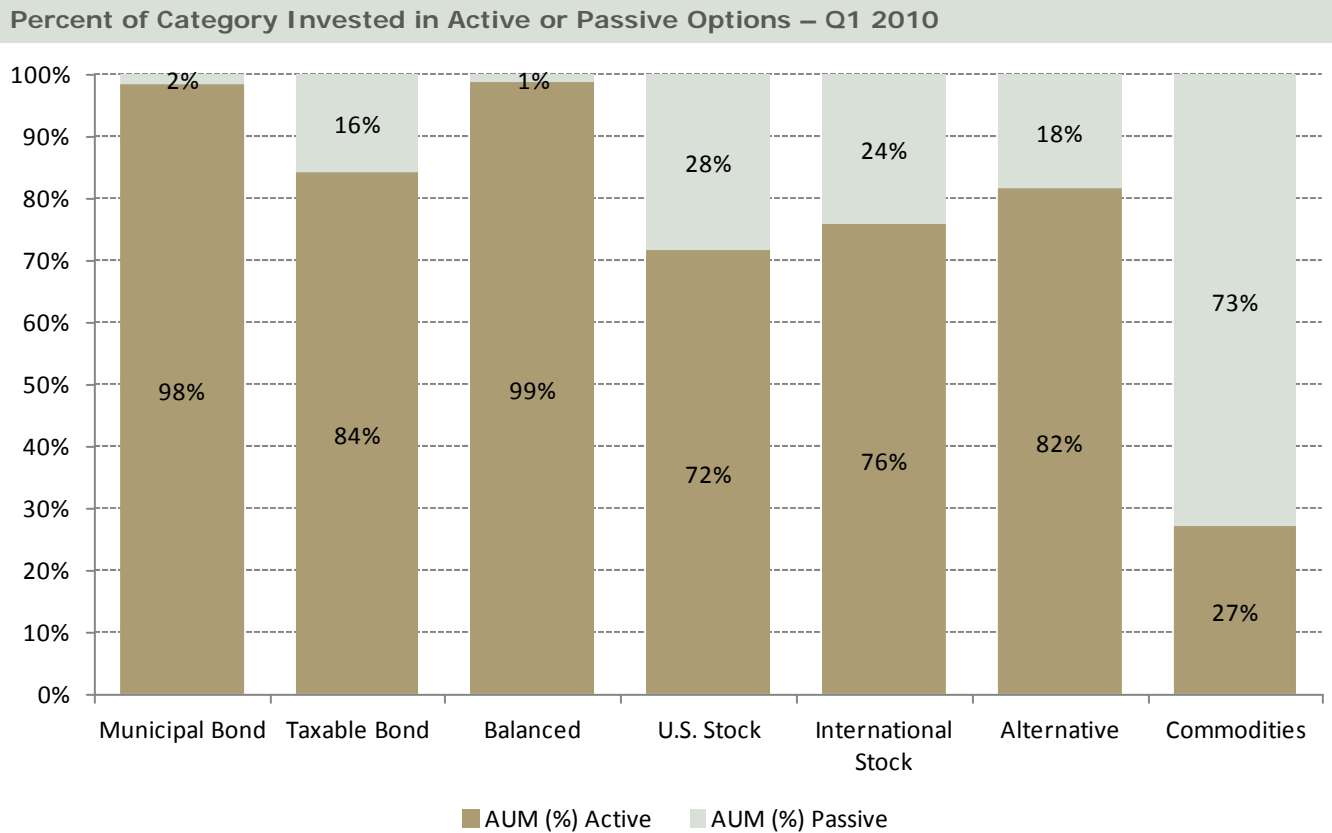
Top 15 \$ Leaders	Trailing 1-Yr Change (\$M)	Market Share (%)	Top 15 \$ Laggards	Trailing 1-Yr Change (\$M)	Market Share (%)
Intermediate-Term Bond	37,246	9.15	Diversified Pacific/Asia	(1,846)	0.40
Diversified Emerging Mkts	17,078	5.60	Financial	(658)	0.68
Short-Term Bond	11,760	1.44	Consumer Staples	2	0.24
Large Blend	10,818	34.47	Foreign Large Growth	49	0.08
Inflation-Protected Bond	10,328	1.37	Health	78	0.51
Foreign Large Blend	9,742	6.52	Communications	140	0.07
Mid-Cap Blend	6,638	4.73	Large Growth	155	3.45
Pacific/Asia ex-Japan Stk	6,135	1.85	Moderate Allocation	157	0.54
Miscellaneous Sector	5,109	0.56	Japan Stock	290	0.38
Small Blend	4,917	3.36	Bear Market	500	0.07
Commodities Broad Basket	4,808	0.56	Intermediate Government	612	0.27
High Yield Bond	4,438	0.56	Foreign Small/Mid Growth	706	0.08
Natural Res	3,872	0.69	Equity Precious Metals	735	0.37
World Bond	3,448	0.64	Global Real Estate	828	0.18
Europe Stock	3,333	1.27	Long-Short	859	0.07

Analysis

Tracking the percentage change in assets displays those categories that are experience the fastest or slowest growth. However, many of these categories are relatively small in terms of market share.

Conversely, tracking the dollar movements across categories displays where the bulk of assets are moving. This can be a combination of traditional passive areas (i.e., index-based options) or more speculative/niche areas where active management is less prevalent.

Active vs. Passive (Total Net Assets)



Analysis

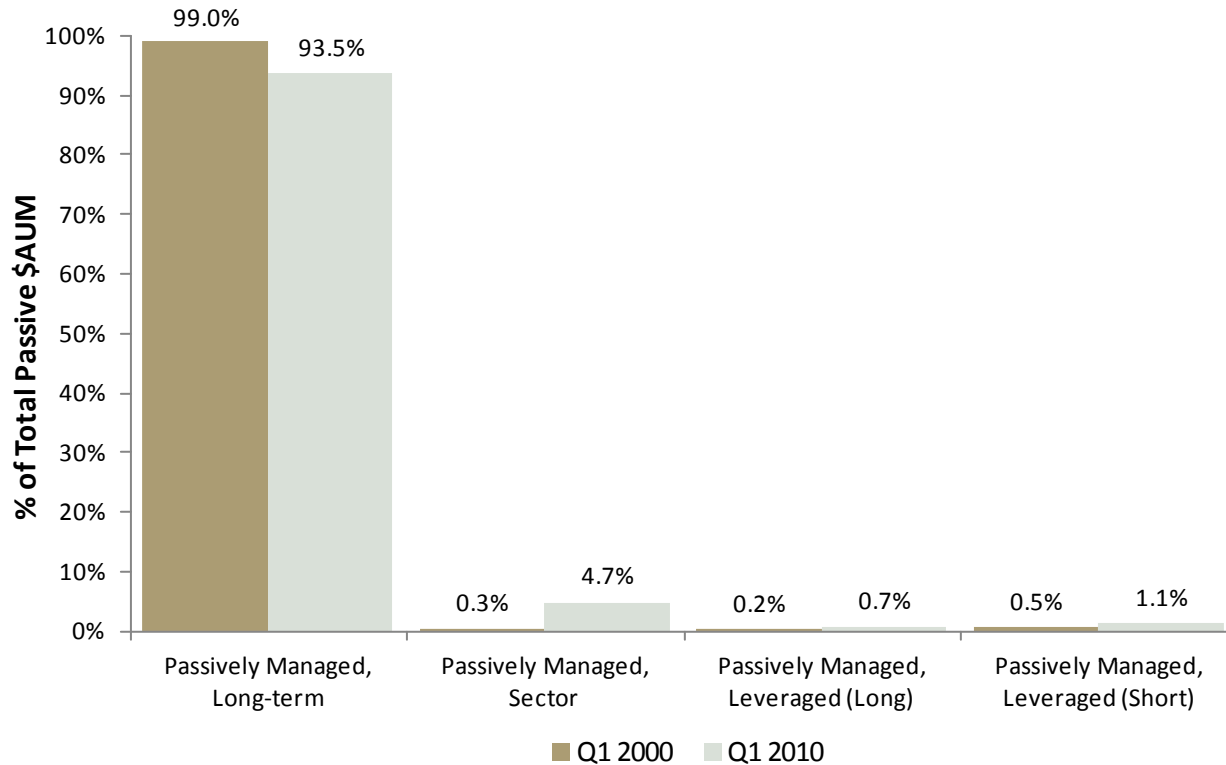
Some asset classes are more efficient than others, meaning it is more optimal to use active management in less efficient areas and passive management in efficient areas.

This analysis shows the percent of assets in each category that are managed in an active or passive style. Active management is clearly the preferred style for bonds, while it is more mixed for stocks.

Despite evidence that active managers can add value in the commodities space with relative ease over time, most investors have preferred passive options. Generally, these are targeted to one specific resource (e.g., gold, oil) and not a broad basket.

Evolution of Passive Management Industry

Composition of Passive Management (Current vs. Ten Years Ago)



Analysis

Long-term passive options (i.e., index funds/ETFs), still dominate the passive landscape. Sector funds/ETFs have grown considerably over the past 10 years, though still represent a small portion of total assets. Lastly, more recently introduced leveraged options have seen some growth, but represent only a fraction of assets.

Important Disclosures

Investors should consider the investment objectives, risks, charges and expenses of any fund carefully before investing. This and other information is found in the prospectus. For a prospectus, contact your Baird Financial Advisor. Please read the prospectus carefully before investing.

An investment in a money market mutual fund is not insured or guaranteed by the FDIC or any other government agency. Although the funds seek to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in a money market fund.

ETFs are subject to the same risks as their underlying securities, trade on an exchange throughout the day and redemptions may be limited and, if purchased outside of a fee-based portfolio, brokerage commissions are charged on each trade.

Past performance is not a guarantee of future results and no investment, regardless of the length of time held, is guaranteed to be profitable. This report is not a complete analysis of every fact and an investment decision should not be made solely of this report.

Investments in international and emerging markets securities include exposure to risks including currency fluctuations, foreign taxes and regulations, and the potential for illiquid markets and political instability. Small- and mid-cap companies may be hindered as a result of limited resources or less diverse products or services and have therefore historically been more volatile than the stocks of larger, more established companies. Investments in commodities expose an investor to potentially high volatility and are generally only suitable for investors with a high tolerance for risk. In a rising interest rate environment, the value of fixed-income securities generally declines and conversely, in a falling interest rate environment, the value of fixed-income securities generally increases. High yield or high dividend securities may be subject to market, interest rate or credit risk and should not be purchased solely because of the stated yield or dividend rate.