Market Strategy
October 19, 2009

Investment Strategy: Q4 2009 Tactical Call

Please refer to Appendix – Important Disclosures.

In this piece, we provide a series of near-term tactical calls within our longer-term strategic framework. We begin by offering commentary on our long-term and near-term outlook for the financial markets. Operating from this premise, we then offer a series of tactical allocation calls, beginning with a macro call on stocks versus bonds versus cash. On the next page, these calls are further distilled. For example, we make distinctions from a size, style and sector perspective for domestic equities, and suggest tilts towards or away from the various satellite asset classes. These calls are made in light of the long-term outlook and summarize our expectations for the coming quarter.

Long-Term Outlook

While the recession's end has likely been reached, the emergence of a self-sustaining recovery remains very much in question. Growth in coming quarters will likely be fueled by inventory re-stocking and government stimulus. Inventory effects are almost by definition transitory, and the actions of the government have not generated growth, so much as re-arranged it – pulling benefits forward and shifting costs to future quarters. Private sector demand is likely to remain muted as businesses and households remain focused on repairing balance sheets by reducing debts. This could leave the economy in a nebulous post-recession/pre-recovery environment marked by volatility. Likewise, while stocks have enjoyed a strong rally off of the March lows (the best back-to-back quarters since the mid-1970's), this cyclical bull market has occurred within the confines of a secular bear market. We would caution against viewing the recent gains as evidence that a buy-and-hold period has re-emerged. Rather, strategic investors should use all areas within an asset allocation framework to manage risks. Within the stock market, investors should stay in-tune with the primary trends, but also be alert for evidence that those trends have run their course.

Near-Term Outlook

Stocks have closed higher in each of the last seven months, rallying on the prospects for recovery and the low inflation and interest rate environment. As we begin the fourth quarter the weight of the evidence continues to favor the bullish case. Our assessment of the economy has been upgraded to neutral from bearish, and while the recession appears to have ended, the genesis of a lasting recovery remains uncomfortably obscured. Fed policy has been downgraded from bullish to neutral on incrementally less involvement by the Fed in the markets, as well as a growing risk presented by the decline in the dollar. Rounding out the fundamental indicators, Valuations have expanded, but remain neutral. The impetus for continued rally remains with the technical indicators. Seasonals/Trends are neutral, although the path traced by the cycle composite suggests an elevated risk for a correction in the near term. Investors are becoming more optimistic, with the latest readings on the brink of turning extreme. While Investor Sentiment still clings to a neutral scoring, this could soon be downgraded to bearish. The Broad Market Trends are bullish, as they have been for much of the rally and could fuel further gains in the indexes. However, with near-term risks having risen, investors should exhibit patience and focus on buying in periods of weakness as opposed to chasing rallies. We would turn increasingly cautious about the near-term prospects should bullish sentiment remain elevated, while divergence between the broad market and the popular averages could be evidence of a longer-term shift.

Tactical Investment Decision	Baird's Call[1]	Date of First Call[2]	Level of Conviction[3]	Rationale
Stocks vs. Bonds vs. Cash?	Stocks Over Bonds and Cash	Q2 09	Medium	• Breadth trends remain a source of strength for stocks. • Valuations have expanded, but are not a headwind, yet.

[1] Tactical over- or under-weight relative to Baird's strategic asset allocation models. Please ask your Baird advisor for more information on the strategic model most applicable to you.
[2] Date when Baird first made this call.
[3] Level of conviction in the tactical investment call: low, medium, high.

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Domestic Stocks: Size	Mid Over Small and Large	Q4 09	Medium	• Aging of the cyclical rally suggests less leadership from small-caps. • Relative strength trends show mid-cap leadership.
Domestic Stocks: Style	Growth Over Value	Q2 09	Low	• Value indexes look expensive relative to growth. • Growth trends have weakened, but have not been broken.
Domestic Stocks: Sector	Energy Health Care Industrials	Q2 09 Q4 09 Q3 09	Medium	• Commodity-sensitive sectors benefitting from strong demand and weak dollar. • Other weak dollar beneficiaries could also become leaders.
Global Stocks: Developed vs. Emerging Markets	Emerging	Q2 09	High	• Leadership remains with emerging markets as global recession has ended. • Favor Asia over Latin America, as an emphasis on growth over commodities.
Global Developed Stocks: Domestic vs. International	International	Q4 09	Low	• U.S. remains a global relative strength laggard. • Second-tier Developed Markets look better than U.S. or Old Europe.
Bonds: Intermediate vs. Short-Term	Short-Term	Q2 09	Medium	• Dollar weakness and lack of Fed buying could push long-term Treasury yields higher. • High-grade corporate still attractive across the curve.
Bonds: High Grade vs. High Yield	High-Grade	Q2 09	High	• Spreads have narrowed as bond fund inflows have squeezed yields. • High-grade spread product preferred to Treasuries.
Satellites: Int'l Real Estate	Underweight Real Estate	Q2 09	Medium	• Commercial real estate still buffeted by near-term and long-term headwinds. • Residential real estate bottoming, but imminent price rise unlikely.
Satellites: Commodities	Overweight Commodities	Q2 09	Low	• Commodities could be vulnerable to near-term reversal in the dollar. • Longer-term commodity trends intact, but may be overbought near term.

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[3] Level of conviction in the tactical investment call: low, medium, high.

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Baird offers six strategic asset allocation model portfolios for consideration (see table below), four of which have a mix of equity and fixed income. An individuals' personal situation, preferences and objectives may suggest an allocation more suitable than those shown below. Please consult a Baird Financial Advisor in determining an asset allocation that will meet your needs.

Model Portfolio	Mix: Stocks / (Bonds + Cash)	Risk Tolerance	Strategic Asset Allocation Model Summary
All Growth	100 / 0	Well above average	Emphasis on providing aggressive growth of capital with high fluctuations in the annual returns and overall market value of the portfolio.
Capital Growth	80 / 20	Above average	Emphasis on providing growth of capital with moderately high fluctuations in the annual returns and overall market value of the portfolio.
Growth with Income	60 / 40	Average	Emphasis on providing moderate growth of capital and some current income with moderate fluctuations in annual returns and overall market value of the portfolio.
Income with Growth	40 / 60	Below average	Emphasis on providing high current income and some growth of capital with moderate fluctuations in the annual returns and overall market value of the portfolio.
Conservative Income	20 / 80	Well below average	Emphasis on providing high current income with relatively small fluctuations in the annual returns and overall market value of the portfolio.
Capital Preservation	0 / 100	Well below average	Emphasis on preserving capital while generating current income with relatively small fluctuations in the annual returns and overall market value of the portfolio.

Baird's Investment Policy Committee offers a view of potential tactical allocations amongst equity, fixed income and cash, based upon a consideration of U.S. Federal Reserve policy, underlying U.S. economic fundamentals, investor sentiment, valuations, seasonal trends, and broad market trends. As conditions change, the Investment Policy Committee adjusts the weightings. The table below shows both the normal range and current recommended allocation to stocks, bonds and cash. Please consult a Baird Financial Advisor in determining if an adjustment to your strategic asset allocation is appropriate in your situation.

Asset Class / Model Portfolio	All Growth	Capital Growth	Growth with Income	Income with Growth	Conservative Income	Capital Preservation
Equities:						
Suggested allocation	95%	80%	60%	40%	20%	0%
Normal range	90 – 100%	70 - 90%	50 - 70%	30 - 50%	10 - 30%	0%
Fixed Income:						
Suggested allocation	0%	10%	30%	40%	45%	60%
Normal range	0 - 0%	10 - 30%	30 - 50%	40 - 60%	45 - 65%	55 – 85%
Cash:						
Suggested allocation	5%	10%	10%	20%	35%	40%
Normal range	0 - 10%	0 - 20%	0 - 20%	10 - 30%	25 - 45%	15 - 45%

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