

Baird Aggregate Bond Inst BAGIX

Analyst Report

by Lawrence Jones

Morningstar's Take | 10-04-07

Baird Aggregate Bond has navigated recent market turbulence well.

Market volatility resulting from the subprime mortgage crisis has weighed slightly on returns here in recent months. Specifically, both the fund's mortgage holdings and its exposure to the bonds of firms in the financials sector hurt modestly in July and August as the liquidity crisis resulted in a classic flight-to-quality. At the time, risk-averse investors shifted assets away from regions of the market perceived as troubled toward areas thought safe, and an underweight to Treasuries (a strongly performing sector), versus the fund's Lehman Brothers U.S. Aggregate Index benchmark, also moderated performance.

Still, we're impressed by how the team played defense. Anticipating some trouble in mortgage and financial issues, lead manager Mary Ellen Stanek and her team pared back assets in the sectors earlier this year. Between the end of 2006 and June 30, the team reduced the fund's stake in mortgage pass-throughs and CMOs and reduced financials exposure too. This helped shield the fund modestly from some of the damage in these sectors. Moreover, since June, the team added to the sectors (for instance, in Merrill Lynch and Lehman Brothers debt) as market weakness resulted in improved valuation.

These recent portfolio moves illustrate well the team's understanding of its own talents and limitations; a pivotal factor for long-term investment success. Stanek argues, for instance, that interest-rate bets are a hard way for managers to consistently add value, so she and her veteran team use an approach that maintains a neutral interest-rate position to the benchmark, while selectively shifting assets by sector and purchasing undervalued securities, clearly their strength.

Beyond having experienced management that can navigate trouble well; this fund's expense advantage provides it a meaningful and sustainable edge.

Lawrence Jones is a fund analyst with Morningstar.

Year	Total Return (%)	+/-Category
YTD	3.59	0.71
2007	—	—
2006	4.87	0.72
2005	2.85	1.05
2004	5.30	1.39

Data through 09-30-2007

Important Disclosure Information

The average annual total returns for the Institutional Class of the Baird Aggregate Bond Fund as of September 30 are 5.07% for the one-year and 5.08% for the five-year periods and 6.61% since its September 29, 2000, inception date. The expense ratio is 0.30%.

Performance data quoted represents past performance. Past performance does not guarantee future results. Investment return and principal value of an investment in the fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. The fund's current performance may be lower or higher than this performance data.

Investors should consider the investment objectives, risks, charges and expenses of the fund carefully before investing. This and other information is found in the prospectus. For a prospectus or for performance current to the most recent month-end, contact Baird Funds directly at 800-444-9102 or contact your Baird Financial Advisor. Please read the prospectus carefully before investing.

Morningstar Rating

★★★★★

Kudos

Experienced management.

Consistent and impressive long-term track record.

Low expenses.

Above-average yield.

Risks

The fund's duration-neutral strategy may moderate returns and keep management from shooting the lights out under certain market conditions.

The fund's high-quality tilt can make it a bit more vulnerable to rising interest rates.

Strategy

Mary Ellen Stanek and her management team set out to consistently beat the fund's benchmark, the Lehman Brothers U.S. Aggregate Index. They peg the fund's duration to that of the benchmark and continuously maintain a duration-neutral interest-rate position. They will then actively attempt to add value through sector allocation and security selection. Thus, management combines passive and active management with broad market and security-specific research to try to outperform the index under varying market conditions.

Management

As managing director and chief investment officer of Baird Advisors, Mary Ellen Stanek leads the team of six seasoned portfolio managers at this intermediate-term bond offering. Stanek, formerly president and chief executive officer of Firststar Investment Research & Management (Firststar Corp.'s money management division), where she worked for 21 years, left for Baird with this team of Firststar veterans in March 2000. The management team ran

several successful funds at Firststar, including its flagship Firststar Bond Immdex Fund.

Inside Scoop

This offering differs from many intermediate-term bond funds in its disciplined duration-neutral approach. The strategy has produced consistently impressive performance over time, and for a fee, the institutional share class is available at a \$10,000 minimum purchase amount on fund platforms at Vanguard and Fidelity.

Role in Portfolio

Core. The fund's broad exposure to bonds in the Lehman Brothers U.S. Aggregate Index, including U.S. Treasury, government agency, corporate, and mortgage-backed securities, as well as management's risk-control discipline, makes this fund a solid core fixed-income holding.

Information through 9/30/07

The Morningstar four-star rating for the Institutional Class Baird Aggregate Bond Fund is the overall rating received among 968 Intermediate-Term Bond Funds. The fund received five stars for the three-year period among 968 Intermediate-Term Bond Funds and four stars for the five-year period among 819 Intermediate-Term Bond Funds.

The overall Morningstar Rating for a fund is derived from a weighted average of the performance figures associated with a fund's three-, five- and ten-year (if applicable) Morningstar Rating metrics.

For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating based on a Morningstar Risk- Adjusted Return measure that accounts for variation in a fund's monthly performance (including the effects of sales charges, loads and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive five stars, the next 22.5% receive four stars, the next 35% receive three stars, the next 22.5% receive two stars and the bottom 10% receive one star. Each share class is counted as a fraction of one fund within this scale and rated separately, which may cause slight variations in the distribution percentages. Past performance is no guarantee of future results.

The fund maintains securities with longer maturities in order to provide a greater potential for return. This may also increase the fund's interest rate risk. Generally, the value of bond funds rises when prevailing interest rates fall and falls when interest rates rise.

This reprint must be accompanied with performance data current through the most recent quarter. For Morningstar ratings data current through the most recent month-end, please visit www.bairdfunds.com.

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