BAIRD

Private Wealth Management

Market Update

Q3 2019 Review and Outlook

Equity markets were mixed in Q3, but remain positive for the year. The S&P 500 gained 1.7% in the quarter and 20.6% YTD. Once again, the US outpaced international equities. Bonds had a strong showing this quarter with a 2.3% return. The 10-Year Treasury yield fell to 1.7%.

Asset Manager Research

(414) 298-7359

October 14, 2019

IN THIS ISSUE

PAGE 2: "TARIFF"-IED?
- Economy
- Fed Policy
- Markets
- Outlook

PAGE 3: EQUITY
- Markets at a Glance
- US Equities Mixed
- International Woes

PAGE 4: FIXED INCOME
- Bonds at a Glance
- Corporate Credit
- Securitized Credit
- Municipal Bonds

The Markets at a Glance

Asset Class	Representative Benchmark	Q3 Return	YTD Return
US Large Cap	S&P 500	1.7%	20.6%
US Small Cap	Russell 2000®	-2.4%	14.2%
International	MSCI EAFE	-1.1%	12.8%
Commodities	Bloomberg Commodity	-1.8%	3.1%
Municipal Bonds	BBgBarc. Municipal	1.6%	6.8%
Taxable Bonds	BBgBarc. Aggregate	2.3%	8.5%
Cash	FTSE 3-Month T-Bills	0.6%	1.8%

Performance returns are as of 9/30/19

Q3 Recap

Fears of an economic slowdown increased during the third quarter, causing investors to seek refuge in the US dollar, defensive stocks, and long-term fixed income. The S&P 500 increased a modest 1.7%, driven by Utilities and Consumer Staples, and is up 20.6% YTD As risks heightened, smaller companies found themselves in the red, with value stocks holding up better than growth among small-and mid-cap equities.

International equities struggled this quarter as the dollar strengthened. Developed markets outperformed emerging markets by over 3%. Taiwan (+5.2%) and Japan (+3.1%) were the best performing markets thanks to strong company results, whereas Hong Kong (-11.9%) and South Africa (-12.6%) fell the most on geopolitical turmoil.

The broad US bond market, as measured by the Bloomberg Barclays US Agg Index, returned 2.3% in Q3. Longer term bonds had another strong quarter with the Bloomberg Barclays US Agg 10+ Yr increasing 6.6% in Q3 and 20.9% YTD. The yield curve remains inverted and the US 10-Year Treasury yield ended the quarter yielding 1.68%. Investors and policymakers continue to monitor the inversion, which often precedes a recession.

Are Markets "Tariff"-ied?

The renegotiation of trade deals between the US and its largest trading partners has been one of President Trump's key initiatives since he took office. Markets have been acutely aware that trade barriers pose risks to the US economy, but these risks have been largely ignored due to strong domestic growth of about 2.5% per annum, a healthy jobs market, deregulation, and tax cuts. In fact, since the election of President Trump, the S&P 500 rallied nearly 50%. In the third quarter, signs indicated that the trade war might finally be affecting the US economy, Federal Reserve policy, and markets.

Economy Cooling?

On the surface, the US economy appears to be on solid footing. GDP grew at a slow-but-steady 2% rate in Q2, with the largest component, consumer spending, rising at the fastest rate in five years. The US consumer has been robust thanks to historically low unemployment, consistent job gains, and optimism about the future. More recently, consumer confidence dipped, leading to speculation that the US consumer may not be immune to the trade war woes. If this shift results in lower spending, US growth could decline in the future. The private sector has already felt the effects of the trade war: manufacturing contracted for the first time since 2009, business investment declined, and exports disappointed.

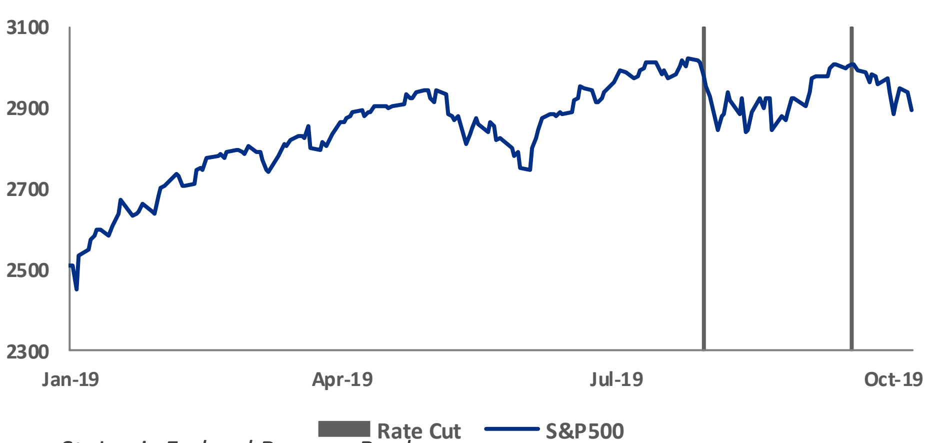
Fed Up with Tariffs

For the first time in a decade, the Federal Reserve reduced the Fed Funds rate by 25 bps on two occasions during Q3 to protect against a slowdown. Interestingly, the market rallied in anticipation of each rate cut and proceeded to selloff on the news (see Figure 1). According to the Fed Funds futures, the market is currently pricing in over an 80% probability of a rate cut in October despite contradicting voices from within the Fed. Their narrative has evolved from a "mid cycle adjustment" to a renewed expansion of the balance sheet that is "not Quantitative Easing". Irrespective of their economic outlook, in the absence of a trade deal monetary policy will become increasingly accommodative in order to sustain the economic expansion and to support the markets.

Markets on Defense

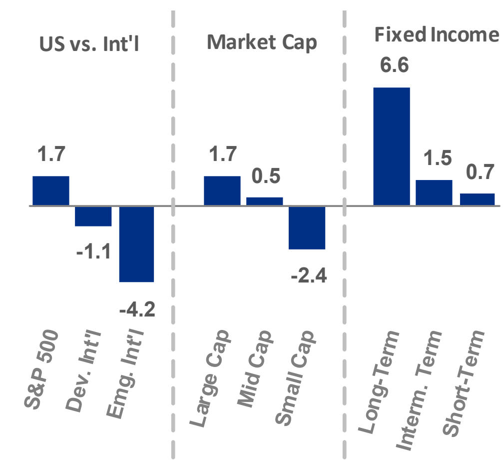
Thanks in large part to the dovish shift in Federal Reserve policy, equity and fixed income markets have been strong in 2019. However, the rally has not been "risk on." In Q3, investors flocked to safety, with bonds outperforming stocks.

Figure 1: S&P 500 Performance vs. Rate Cuts



Source: St. Louis Federal Reserve Bank

Figure 2: Q3 Market Snapshot



Source: MorningstarDirect

Within equities, investors favored the US over international, large- over small-cap, and defensive sectors over cyclicals. In Fixed Income, demand for longer-dated bonds continued with the BBgBarc US Agg 10+ Yr up nearly 7% vs. 1% for bonds with less than 3 years to maturity.

Going Forward

There appears to be no end in sight for the trade disputes. New tariffs have been imposed on Europe and visas have been revoked for Chinese citizens, further complicating the negotiations. Federal Reserve Chair Powell has attempted to reassure markets throughout the year with accommodative policy, but the words have come up short as trade turmoil effects are difficult to contain.

Although a resolution between the US and China seems out of reach on any given day, there is the possibility that President Trump tones down his rhetoric as the 2020 election approaches. For now markets and the economy seem to be resilient and only slightly "tariff"-ied.

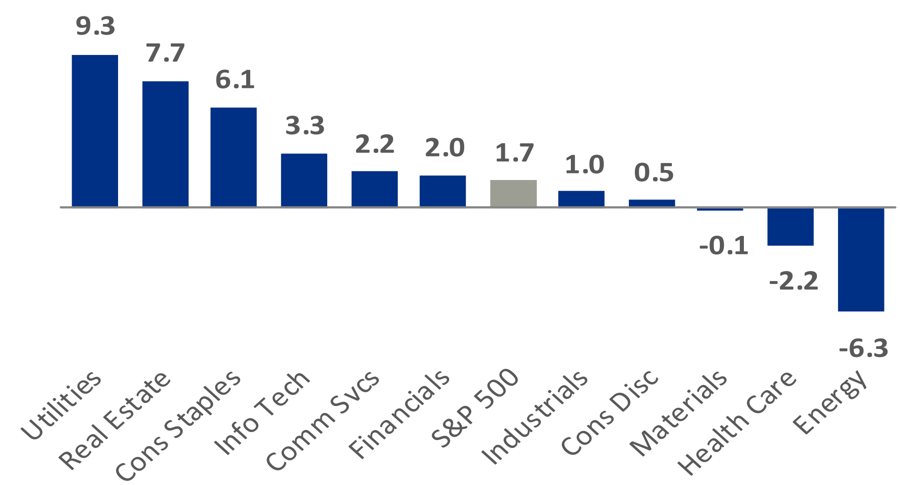
Equity Markets

U.S. Equity Market Benchmarks

Equities	Representative Benchmark	Q3 Return	YTD Return
US Large	S&P 500	1.7%	20.6%
US Mid	Russell Midcap®	0.5%	21.9%
US Small	Russell 2000®	-2.4%	14.2%
US Value	Russell 3000 Value	1.2%	17.5%
US Growth	Russell 3000 Growth	1.1%	22.8%
Dev. Int'l	MSCI EAFE	-1.1%	12.8%
Emg. Int'l	MSCI EM	-4.3%	5.9%

Performance returns as of 9/30/2019

Figure 3: Q3 Sector Performance



Source: MorningstarDirect

Markets at a Glance

Equity markets ended the quarter in mostly positive territory despite mixed economic data and a continuation of trade tensions. Investors were decidedly defensive as they favored the US over international and large-cap over mid– and small-cap stocks. The growth style, which has been dominant over value all year long, was actually a detractor for small– and mid-cap equities.

Mixed Results for US Equities

Returns for US equities were mixed this quarter. Size was a significant driver for performance, with the Russell Top 200 (+1.8%) outperforming the Russell Micro-Cap Index (-5.5%) by over 7% in Q3. Within Large-Cap, Growth and Value performed roughly in-line with each other, but the same was not true for smaller companies. Value outperformed Growth by 3.6% and 1.9% respectively for Small– and Mid-Cap stocks. On the year, Mid-Cap Growth was the best performing style with a 25.2% return while Micro-Cap and Small-Cap Value lagged with respective YTD returns of 7.9% and 12.8%.

In addition to favoring larger companies this quarter, market participants also preferred defensive sectors over cyclicals. Utilities and Consumer Staples were strong performers, with quarterly returns of 9.3% and 6.1%. Low interest rates also drove the rally in the Real Estate sector (+7.7%). Energy stocks bounced around along with oil prices and ended up being the worst performing sector for the second quarter in a row, falling 6.3% for the quarter. For the year, Energy is a laggard with a return of 6%. Health Care, which is often grouped with defensive sectors, did not fit with the "flight to safety" theme. Health Care fell 2.3% during the quarter and is the worst performing sector this year, with a return of just 5.6%. The health care industry faces the threat of government intervention if democrats win big in 2020. The President has also targeted the industry in the past as surging health care costs weigh on Americans' and the government's budget. On the year, Information Technology remains the strongest performer with a 31% return, followed by Real Estate (+29.7%) and Utilities (+25.4%).

International Markets Lower

International equities struggled in Q3. Developed markets fell 1% and emerging markets slumped 4.3%. The strong US dollar knocked off nearly 2% of returns for both the MSCI EAFE and MSCI EM benchmarks. Within developed markets, Japan (+3.1%) was the best performer while Hong Kong slumped 12% as protests took a toll on the economy. Europe continues to disappoint economically and the European Central Bank responded by indicating that more quantitative easing is on the way. Investors have not been overly enthusiastic as the MSCI Europe Index fell 1.8% during the quarter. Worries about the EU's largest economy, Germany, also persisted during the quarter as economic data continued to disappoint ; equities fell 4%.

Within EM, Taiwan posted the lone positive return of 5.2%, driven by Taiwan Semiconductor, which generates much of its revenues from developed markets. The rest of the emerging world was more somber. South Africa dropped 12.6% as the country faces prolonged geopolitical and economic trouble. China fell 4.7%, slightly worse than the EM Index, as the tariff tensions weighed on the economy. China's GDP growth has already been slowing since 2011 as it transitions from an export-driven to a consumer-driven economy. Brazil, India, and Korea similarly fell between 4-6% during the period.

Fixed Income

U.S. Fixed Income Benchmarks

Fixed	Representative	Q3 Return	YTD Return
Taxable	BBgBarc. Aggregate	2.3%	8.5%
Treasury	BBgBarc. Treasury	2.4%	7.7%
Corporate	BBgBarc. Corporate	3.1%	13.2%
High Yield	ICE BofAML US HY	1.2%	11.5%
Municipal	BBgBarc. Municipal	1.6%	6.8%
Int'l	BBgBarc. Global Agg.	0.7%	6.3%

Performance returns as of 9/30/2019

Fixed Income at a Glance

During Q3 2019, the only certainty in fixed income markets was uncertainty. The broad US bond market returned 2.3% to investors as risk sentiment continued on its roller coaster. Following the Fed's "hawkish cut" in late July, US interest rates turned sharply lower as trade tensions heightened and global growth forecasts fell. These concerns led to significant demand for high quality fixed income assets. Demand for US Treasuries pushed rates to levels not seen since 2016. The 10-Year Treasury Yield ended the quarter at 1.68%, falling 32 bps in Q3. During the 3rd quarter, the market's attention was directed back to the 3-Month/10-Year Spread, which first inverted back in March, and remains inverted at minus 20 bps. Investors also recognized there might be a bit of stress building in short term liquidity markets. As seen in Figure 4, overnight repurchase agreements, a market used by financial institutions to fill short-term liquidity gaps, saw an enormous jump in rates. The market will be keeping a watchful eye on a potential build-up of market stress driven by the inversion as well as liquidity pressure from "repo" markets.

Outside the US, central banks have made an effort to stave off the effects of slowing growth. In September, the European Central Bank announced its much anticipated policy rate cut (to –0.5%) along with the a restart of their €20B per month purchase plan and tiering for banks to ease the pressure of negative rates. During the quarter, the Bank of Japan reduced the pace its asset purchases in response to the rally in Japanese fixed income markets pushing yields on Japanese Government Bonds (JGBs) below its 0% target. The cloud of uncertainty extends over the Japanese economy next month as the planned hike in their sales tax from 8% to 10% could suppress domestic consumption.

Corporate Credit In High Demand

Despite bouts of volatility in Q3, corporate credit benefited from continued monetary policy accommodation and demand coming from yield starved investors. Investment grade and high yield debt delivered solid returns in Q3, gaining 3.1% and 1.2% respectively. Corporate debt issuance picked up in Q3, with close $403 billion coming to the market. In an effort to take advantage of low yields and tight spreads, corporate issuers are issuing debt to refinance their current debt load, extending the maturity and lowering their interest expense. As growth driven uncertainty mounts, market participants will be zeroing in on earnings growth or lack thereof. Increased leverage with waning earnings forecast could be a cause for concern going forward. High yield corporates rated CCC or below (-2.3%) suffered in Q3 as risks for a lower growth forecast mounted causing spreads for riskier securities to widen and prices lower.

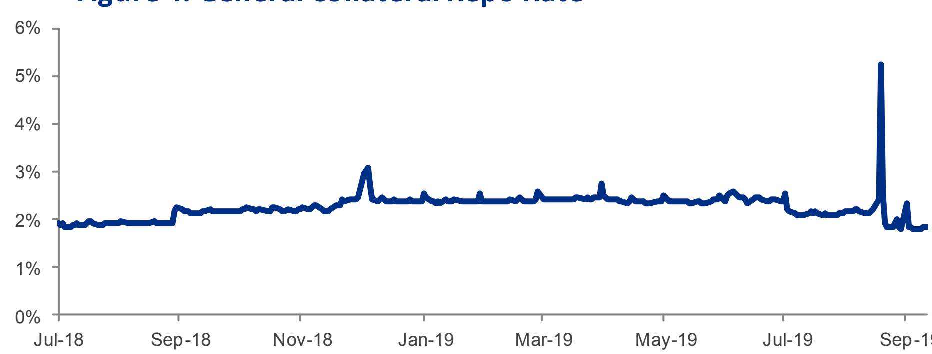
Securitized Credit Holds Up In Q3

Despite the underperformance in August, Mortgage-Backed Securities delivered 1.4% in Q3, underperforming Treasuries by 103 bps. The underperformance was generally driven by homeowners electing to refinance. Asset-Backed Securities continued to present strong risk adjusted returns for investors, delivering 0.9% supported by attractive collateral and solid structural enhancements.

Municipal Bonds

Municipal bonds rose 1.6% in Q3, underperforming taxable peers by 69 bps. Strong technicals and encouraging fundamentals supported the positive performance. Taxable municipal bonds was the top performing sector increasing 3.4%, while pre-refunded municipal bonds suffered, only up 0.4% in Q3.

Figure 4: General Collateral Repo Rate



Source: Bloomberg, Baird

Appendix Definitions and Disclosures

Benchmark and Asset Class Definitions

S&P 500 Index (Large Cap / U.S. Stocks): A representative sample of 500 leading companies in leading industries of the U.S. economy. These are equity securities of large capitalization (generally $7 billion plus market cap) companies having growth and value characteristics.

Russell 3000® Growth Index (All Cap Growth / Growth Stocks): Measures the performance of the 3,000 largest U.S. companies based on total market capitalization with higher price-to-book ratios and higher forecasted growth values.

Russell 3000® Value Index (All Cap Value / Value Stocks): Measures the performance of the 3,000 largest U.S. companies based on total market capitalization with lower price-to-book ratios and lower forecasted growth values.

Russell 1000® Growth Index (Large Growth): Measures the performance of those Russell 1000® Index companies with higher price-to-book ratios and higher forecasted growth values. These are equity securities of large capitalization ($7 billion plus market cap) companies having growth stock characteristics (high price to earnings, high return on equity and low dividend yield.

Russell 1000® Value Index (Large Value): Measures the performance of those Russell 1000® Index companies with lower price-to-book ratios and lower forecasted growth values. These are equity securities of large capitalization ($7 billion plus market cap) companies having value stock characteristics (low forecasted price-to-earnings ratio, low price-to-book ratio, high dividend yield).

Russell Midcap® Index (Mid Cap / Mid Core): Measures the performance of the 800 smallest companies of the Russell 1000® Index, which represent approximately 31% of the total market capitalization of the Russell 1000® Index. These are equity securities of middle capitalization ($2-7 billion plus market cap) companies having growth and value characteristics.

Russell 2000® Index (Small Cap / Small Core): Measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represent approximately 10% of the total market capitalization of the Russell 3000® Index. These are equity securities of small capitalization (<$2 billion plus market cap) companies having growth and value characteristics.

Russell Micro Cap Index (Micro Cap): Measures the performance of the 1,000 smallest companies in the Russell 2000® Index, which represent approximately 3% of the total market capitalization of the Russell 3000® Index.

MSCI EAFE Index Net (International / Developed Markets): A free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. As of May 27, 2010 the MSCI EAFE Index consisted of the following 22 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.

FTSE 3-month T-bill Index (Cash): This index measures monthly return equivalents of yield averages that are not marked to market. It consists of the last one-month and three-month Treasury bill issues, respectively.

Bloomberg Commodity Index (Commodities): Composed of commodities traded on U.S. exchanges, with the exception of aluminum, nickel and zinc, which trade on the London Metal Exchange (LME). Sub-indices include Petroleum, Grains, Industrial Metals, Livestock, Precious Metals, and Softs

MSCI Emerging Markets Index Net (Emerging Markets): A free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of May 27, 2010 the MSCI Emerging Markets Index consisted of the following 21 emerging market country indices.

MSCI Country Indices (Country-Specific Markets): To construct an MSCI Country Index, every listed security in the market is identified. Securities are free float adjusted, classified in accordance with the Global Industry Classification Standard (GICS®), and screened by size and liquidity. MSCI then constructs its indices by targeting for index inclusion 85% of the free float adjusted market capitalization in each industry group, within each country. By targeting 85% of each industry group, the MSCI Country Index captures 85% of the total country market capitalization while it accurately reflects the economic diversity of the market. This includes the MSCI Japan Index. International indices.

BBgBarc Aggregate Bond Index (Taxable Bonds / Bonds): Comprised of approximately 6,000 publicly traded bonds, including U.S. Government, mortgage-backed, corporate, and Yankee bonds with an average maturity of approximately 10 years.

BBgBarc Global Aggregate Bond Index (Global Bonds): Provides a broad-based measure of the global investment-grade fixed income markets. The three major components of this index are the U.S. Aggregate, the Pan-European Aggregate, and the Asian-Pacific Aggregate Indices. The index also includes Eurodollar and Euro-Yen corporate bonds, Canadian government, agency and corporate securities, and USD investment grade 144A securities.

BBgBarc Muni Bond Index (Municipal Bonds): Bonds must have a minimum credit rating of at least Baa, an outstanding par value of at least $3 million, part of a transaction of at least $50 million, issued after December 31, 1990 and have a year or longer remaining maturity.

BBgBarc U.S. High Yield Bond Index (High Yield): Covers the universe of fixed rate, non-investment grade debt. Eurobonds and debt issues from countries designated as emerging markets (e.g., Argentina, Brazil, Venezuela, etc.) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures, 144-As and pay-in-kind bonds (PIKs, as of October 1, 2009) are also included.

BBgBarc U.S. Treasury Bond Index (Treasury Bonds): Comprised of U.S Treasury securities with at least one-year maturities.

Appendix Definitions and Disclosures

GICS

The Global Industry Classification Standard ("GICS") is the exclusive property of Morgan Stanley Capital International Inc. ("MSCI") and Standard & Poor's, a division of The McGraw-Hill Companies, Inc. ("S&P") and is licensed for use by Robert W. Baird & Co. Inc. MSCI and S&P hereby provided all information "as is" and expressly disclaim all warranties. Without limiting any of the foregoing, in no event shall MSCI or S&P have any liability.

The Russell Indices are a trademark of the Frank Russell Company. Russell® is a trademark of the Frank Russell Company.

Investors should consider the investment objectives, risks, charges and expenses of each fund carefully before investing. This and other information is found in the prospectus and summary prospectus, which can be obtained from your Baird Financial Advisor. Please read the prospectus or summary prospectus carefully before investing.

Appendix – Important Disclosures and Definitions.

Disclaimers

This is not a complete analysis of every material fact regarding any company, industry or security. The opinions expressed here reflect our judgment at this date and are subject to change. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy. Past performance is not a guarantee of future results and diversification does not ensure against market loss.

There are risks associated with all investments which should be considered prior to investing. Small-capitalization and mid-capitalization stocks are often more volatile and less liquid than investments in larger companies. Satellite and alternative investments can be volatile and are not appropriate as large percentages of an investor's total asset allocation. Foreign issuers are subject to certain risks, such as the potential for political or economic disruptions or instability of the country of issue, the difficulty of predicting international trade patterns, foreign currency fluctuations, and the possibility of imposition of exchange controls. Investments in lower-rated debt securities (commonly referred to as high-yield or junk bonds) involve additional risks because of their lower credit quality which could equate to a possibly higher level of volatility and increased risk of default. While sector investing reduces company specific risk, it will still be more volatile than the overall stock market due to its narrow focus and lack of diversification.

Stocks represent partial ownership of a corporation. If the corporation does well, its value increases, and investors share in the appreciation. However, if it goes bankrupt, or performs poorly, investors can lose their entire initial investment (i.e., the stock price can go to zero). Bonds represent a loan made by an investor to a corporation or government. As such, the investor gets a guaranteed interest rate for a specific period of time and expects to get their original investment back at the end of that time period, along with the interest earned. Investment risk is repayment of the principal (amount invested). In the event of a bankruptcy or other corporate disruption, bonds are senior to stocks. Investors should be aware of these differences prior to investing. Additionally, an investment decision should not be made solely due to a security's stated yield as dividends can be reduced or suspended altogether. The indices referenced in this report are unmanaged common indices used to measure and report performance of various sectors of the stock and fixed income markets; direct investment in indices is not available.

Baird is exempt from the requirement to hold an Australian financial services license. Baird is regulated by the United States Securities and Exchange Commission, FINRA, NYSE, and various other self-regulatory organizations and those laws and regulations may differ from Australian laws. This report has been prepared in accordance with the laws and regulations governing United States broker-dealers and not Australian laws.

Credit Quality Ratings: Measured on a scale that ranges from AAA or Aaa (highest) to D or C (lowest). Investment grade investments are those rated from highest down to BBB- or Baa3.

Other Disclosures

UK disclosure requirements for the purpose of distributing this research into the UK and other countries for which Robert W Baird Limited holds an ISD passport.

This report is for distribution into the United Kingdom only to persons who fall within Article 19 or Article 49(2) of the Financial Services and Markets Act 2000 (financial promotion) order 2001 being persons who are investment professionals and may not be distributed to private clients. Issued in the United Kingdom by Robert W Baird Limited, which has offices at Mint House 77 Mansell Street, London, E1 8AF, and is a company authorized and regulated by the Financial Conduct Authority. For the purposes of the Financial Conduct Authority requirements, this investment research report is classified as objective.

Robert W Baird Limited ("RWBL") is exempt from the requirement to hold an Australian financial services license. RWBL is regulated by the Financial Conduct Authority ("FCA") under UK laws and those laws may differ from Australian laws. This document has been prepared in accordance with FCA requirements and not Australian laws.