

## Market Update: Q2 2011 Review and Outlook

Please refer to Appendix – Important Disclosures.

### Q2 2011 Recap

The second quarter was a much bumpier ride than the S&P 500 Index's 0.1% return would suggest. Optimism stemming from a strong Q1 spilled over into April as the U.S. stock market continued its advance, shrugging past the headline-grabbing news that S&P lowered its outlook on U.S. government debt to Negative from Stable. Stocks reached an intra-quarter high on May 3 – the same day it was announced that Osama bin Laden was killed. From there the market began to consolidate and there were six consecutive weeks of losses as economic releases confirmed a slowdown in the global recovery. The major stock indices closed the quarter with a dramatic 4-day, 4%+ rally that changed what would have been a negative quarter into one with mixed results. An area of notable strength was the bond market, especially the municipal bond market, which posted solid Q2 results.

Due to our regular interactions with clients nationwide Baird is uniquely tuned in to the pulse of investors, both individual and institutional. One theme that resonates across client types is the recognition that we are in a period of heightened uncertainty. Three major questions causing consternation on the part of investors are: How strong will the U.S. economy be without the assistance of government stimulus? How will the untenable debt problem in the U.S. be solved? When will interest rates and inflation head higher? The answers to some of these questions are too difficult to forecast and will only become clearer over time; others will be addressed in our investment strategy outlook, beginning on page 9. This edition of *Market Update* will focus, as always, on identifying the drivers of market performance; however, we will also highlight several actions that investors can take to update their portfolio for current market conditions.

In our view, there were seven key themes in Q2 2011, many of which are reversals of previous trends:

- The risk trade switch was turned off in Q2
- Large Caps reversed trend and outperformed Small Cap; Growth handily outperformed Value
- More defensive sectors and those with yield protection were favored over cyclical areas
- Commodities (except gold) pulled back
- Continued differentiation in international markets
- Improving trends for active managers
- Solid showing from bonds, especially Municipals

Below we analyze these themes, and beginning on page 9 we offer our economic and stock market outlook.

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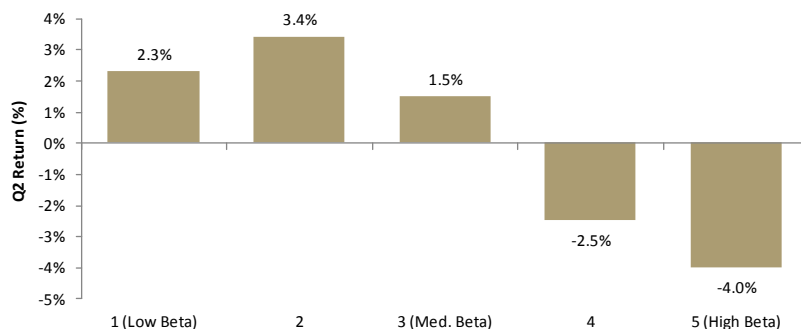
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### The Risk Switch Was Turned Off in Q2

The trading environment over the past two years has often been described as “risk-on, risk-off” characterized by distinct shifts between ‘riskier’ and ‘safer’ investments. In last quarter’s *Market Update* we made note that the risk-on environment that had persisted through the better part of 2009 and 2010 appeared to be waning. It was indeed the case that the trend finally reversed in Q2. This can perhaps be best illustrated by examining the performance of stocks with different betas. A stock’s beta represents its sensitivity to market movements – the higher the beta, the more volatile the stock. For instance, a stock with a beta of 1.5 would be expected to return +/- 15% if the market moved 10%. Figure 1 shows the performance of stocks within the S&P 500 Index categorized by beta quintiles (or one-fifths). Those with the lowest betas, or perceived to be the least risky, advanced 2.3% on average while those with the highest betas declined 4.0%. According to our analysis this preference for less volatile stocks existed across all major asset classes.

**Figure 1: S&P 500 Return by Beta Quintile**



Source: Standard & Poors; Vestek; Baird Analysis.

The reversal in risk-seeking trends was not isolated to the impacts of beta. In fact, we witnessed this reversal across various measures that we have been following for some time. Below is a table that we first included in the Q4 2010 *Market Update* and have since incorporated newer data. It denotes any evidence of increased risk-taking and the magnitude of that measure (in parentheses). During the last three quarters we have followed the market through a risk-induced market to one of risk aversion. This is evidenced by looking at asset allocation, market cap, sectors, quality, and leadership in the international and fixed income markets, among others. In the following sections we will elaborate on some of the more meaningful trend reversals.

	Evidence of Increased Risk-Taking	Q4 2010 Outcome (Amount)	Q1 2011 Outcome (Amount)	Q2 2011 Outcome (Amount)
<b>Asset Allocation</b>	Stocks outperformed Bonds	Yes (+1200 bp)	Yes (+550 bp)	No (-220 bp)
<b>Market Cap</b>	Small Cap outperformed Large Cap	Yes (+550 bp)	Yes (+200 bp)	No (-160 bp)
<b>Sectors</b>	Cyclical areas outperformed Defensive areas	Yes (+1140 bp)	Yes (+510 bp)	No (-200 bp)
<b>Quality</b>	Low quality companies outperformed High quality	Yes (+140 bp)	Yes (+140 bp)	No (-205 bp)
<b>International</b>	Emerging Markets outperformed Developed Markets	Yes (+70 bp)	No (-135 bp)	No (-290 bp)
<b>Fixed Income</b>	High Yield outperformed Investment Grade	Yes	Yes (taxable), No (municipal)	No (taxable), Yes (municipal)

### Large Cap Reversed Trend and Outperformed Small Cap; Growth Handily Outperformed Value

Market-cap leadership moved higher in Q2 with Large Cap outperforming Small Cap by a wide margin (Figure 2). Yet both trailed Mid Cap, which continues to be the market's sweet spot in terms of company size. From a style perspective there was a clear penchant for Growth stocks relative to Value stocks (Figure 3). Generally Growth stocks have better earnings prospects and carry less debt on the balance sheet, making them more attractive to investors looking for companies that can manage through more turbulent times.

Figure 2: Q2 2011 Index Returns by Market Cap Segment

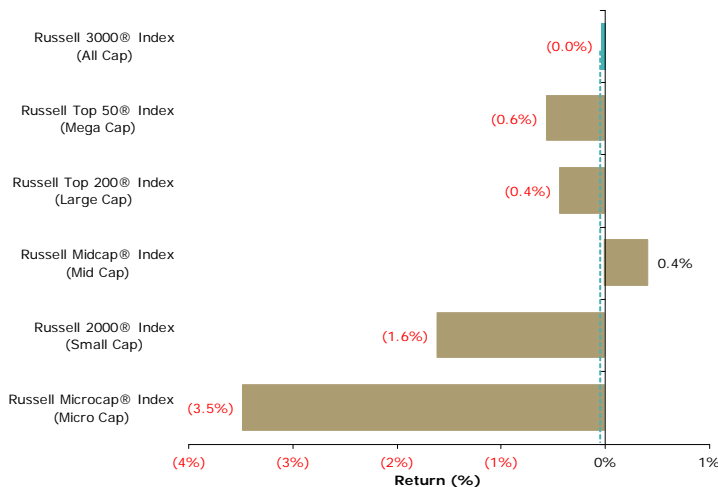
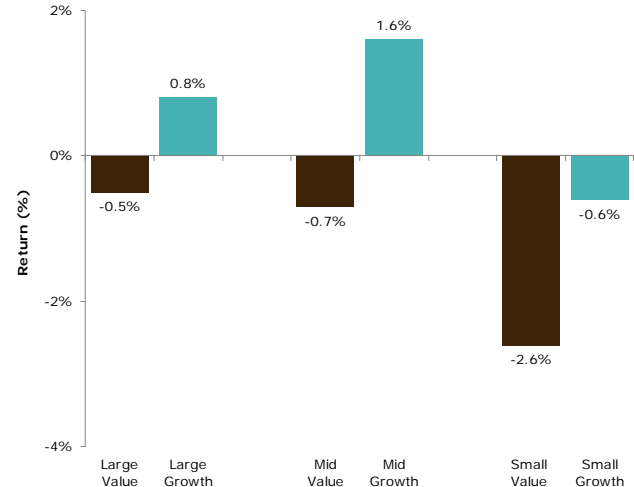


Figure 3: Q2 2011 Index Returns by Style



Source: Russell benchmarks (please see Appendix - Important Definitions).

The fact that Large Cap trumped Small Cap in Q2 is worth more than a passing mention. Market-cap leadership ebbs and flows through economic cycles with smaller companies generally leading the recovery and then typically transitioning leadership to large companies when the cycle is more stable or even declining. This latest market cycle has been no different. On the figure below we list the quarterly results based on company size – Micro Cap, Small Cap, Mid Cap, and Large Cap – as well as a more evenly distributed All Cap benchmark. During the market downturn (Q3 2007 – Q1 2009) Large Cap held up better than Small and Micro Cap as investors sought safety in more established companies. The opposite is true during the recent market recovery that has undoubtedly been fueled by the performance of smaller companies. This is what makes Large Cap's Q2 outperformance over Small and Micro Cap more meaningful. While one quarter does not necessarily mark an inflection point, when combined with other evidence such as beta, sector and quality leadership shifts, a case can be made that the market is moving away from a lopsided risk-on environment. Of course, another round of Fed stimulus may change that picture.

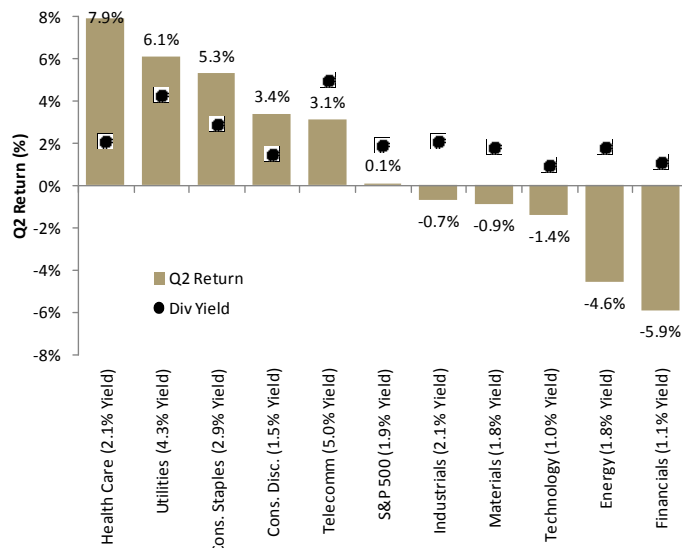
QUARTERLY RETURNS (Market Downturn)							QUARTERLY RETURNS (Market Recovery)								
Q3 2007	Q4 2007	Q1 2008	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011	Q2 2011
Large Cap 3.0%	Large Cap -3.1%	Large Cap -9.3%	Mid Cap 2.7%	Micro Cap -0.8%	Large Cap -20.6%	Mid Cap -9.0%	Micro Cap 25.0%	Micro Cap 20.9%	Large Cap 6.1%	Micro Cap 9.9%	Micro Cap -8.9%	Mid Cap 13.3%	Micro Cap 19.4%	Small Cap 7.9%	Mid Cap 0.4%
All Cap 1.6%	All Cap -3.3%	All Cap -9.5%	Small Cap 0.6%	Small Cap -1.1%	All Cap -22.8%	All Cap -10.8%	Mid Cap 20.8%	Mid Cap 20.6%	Mid Cap 5.9%	Small Cap 8.9%	Mid Cap -9.9%	All Cap 11.5%	Small Cap 16.3%	Mid Cap 7.6%	All Cap 0.0%
Mid Cap -0.4%	Mid Cap -3.6%	Small Cap -9.9%	All Cap -1.7%	Large Cap -7.9%	Small Cap -26.1%	Large Cap -11.0%	Small Cap 20.7%	Small Cap 19.3%	All Cap 5.9%	Mid Cap 8.7%	Small Cap -9.9%	Small Cap 11.3%	Mid Cap 13.1%	Micro Cap 6.8%	Large Cap -0.4%
Small Cap -3.1%	Small Cap -4.6%	Mid Cap -10.0%	Micro Cap -3.5%	All Cap -8.7%	Mid Cap -27.3%	Small Cap -15.0%	All Cap 16.8%	All Cap 16.3%	Small Cap 3.9%	All Cap 5.9%	All Cap -11.3%	Large Cap 10.8%	All Cap 11.6%	All Cap 6.4%	Small Cap -1.6%
Micro Cap -4.6%	Micro Cap -7.5%	Micro Cap -12.4%	Large Cap -3.7%	Mid Cap -12.9%	Micro Cap -28.1%	Micro Cap -15.2%	Large Cap 14.9%	Large Cap 14.4%	Micro Cap -0.5%	Large Cap 4.6%	Large Cap -12.1%	Micro Cap 7.8%	Large Cap 10.4%	Large Cap 5.6%	Micro Cap -3.5%

**More Defensive, Higher-Yielding Sectors Set the Pace**

Consistent with the pervasive Q2 trend of a reassessment of risk, the more defensive sectors of the market – Health Care, Utilities, Consumer Staples, and Telecomm - outperformed the more economically-sensitive areas. The defensive sectors were attractive due to their lower beta (volatility) measures and because of the higher dividend yields that often accompany stocks in these sectors. Figure 4 sorts the sectors of the S&P 500 by performance. Defensive sectors and/or those with above-benchmark yields generally posted positive returns. The lone exception is the Consumer Discretionary sector, which isn't a higher-yielding sector but did show strength in the quarter.

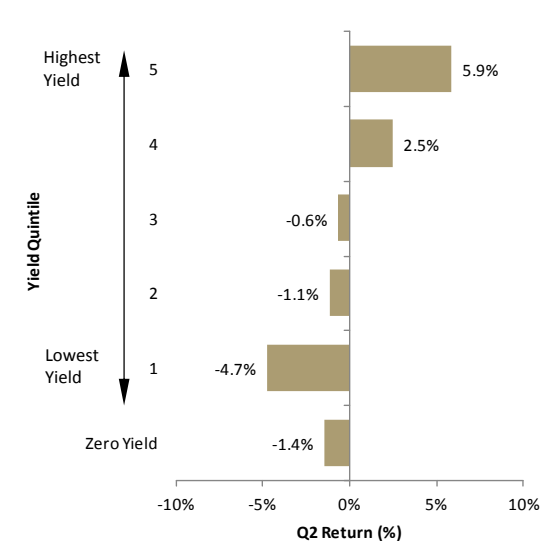
Understanding the drivers of investment returns is often more important than just reporting what happened in a given period. To that extent, we wanted to ascertain whether it was investors' preferences for high yield (a more company-specific decision) or low beta (a more sector-specific decision) that drove investment returns. Figure 5 disregards sectors and separates the stocks within the S&P 500 into six categories based on yield. It is clear that the highest yielding stocks outperformed by a wide margin, concluding that more attention to yield was in fact a driver of performance. In our view, the shift to more defensive sectors and the outperformance of higher-yielding stocks are not independent. It is likely that both factors were considered as investors decreased the levels of risk in their portfolios.

**Figure 4: S&P 500 Index Sectors Returns and Dividend Yields**



Source: Standard & Poors; Vestek; Baird Analysis.

**Figure 5: S&P 500 Return by Yield Quintile**



Source: Standard & Poors; Vestek; Baird Analysis.

**Commodities (except Gold) Pulled Back in Q2**

Commodities pulled back in Q2 after advancing at a gangbuster pace since the market low in March 2009. This came on the heels of several economic releases that showed a slowdown in the global recovery, which many attribute to elevated energy and food prices. The broad Dow Jones UBS Commodity Index fell 6.7% in Q2, led by declines in the grains and oil categories. In what can only be seen as good news to most consumers, the price of oil settled at \$95/barrel at the end of the quarter after starting Q2 at \$107/barrel. The lone exception to the commodity retreat was gold, though this is more often invested in as a quasi-currency or a risk hedge than a commodity. The price of an ounce of gold rose nearly 5% in the quarter.

**Continued Differentiation in International Markets**

Like in the U.S., international markets are grappling with various headline risks. This is causing differentiation between those economies that are thought to be in good standing and those that are not. In Europe, concerns surround heavily-indebted nations such as Greece and Portugal and how much aid it will take from the EU to bail them out. In Asia, Japan is still recovering from the devastating tsunami and its all-important manufacturing sector is getting production slowly ramped up. In many emerging markets – China and India are prime examples – steps have been taken to quell rising inflation including raising interest rates, which lessens the attractiveness of stocks in the country. The table below highlights some of the leaders and laggards by region. The

divergence in country returns is important because this gives U.S. investors a broader opportunity set and possibility for diversification.

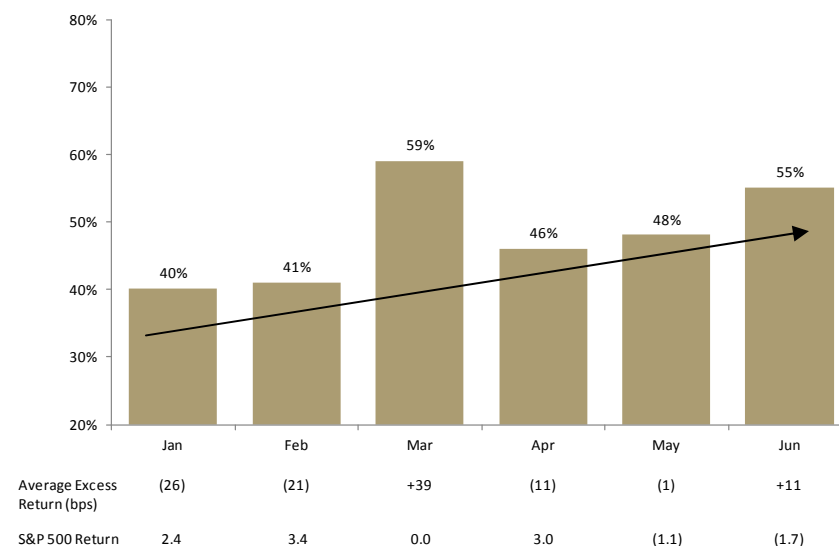
Region/Country	Leaders (Q2 Return)	Laggards (Q2 Return)
<b>Developed Markets</b>		
Developed Asia	Singapore (+2.0%)	Hong Kong (-1.0%)
North America	U.S. (+0.1%)	Canada (-4.6%)
Western Europe	Germany (+7.0%), France (+5.3%)	Denmark (-6.4%), Netherlands (-4.2%)
Australasia	Japan (+0.2%)	Australia (-0.6%)
<b>Emerging Markets</b>		
Emerging Asia	Taiwan (+1.7%), South Korea (+0.9%)	India (-3.6%), China (-1.8%)
Latin America	Chile (+8.8%)	Brazil (-4.0%)
Emerging Europe	Czech Republic (+6.3%)	Russia (-5.4%)
Middle East & Africa	N/A	Israel (-5.1%), South Africa (-2.0%)

The MSCI EAFE Index, a broad international benchmark, outperformed the U.S. S&P 500, 1.8% versus 0.1%. However, this was almost entirely due to the drop in the U.S. Dollar relative to most major currencies. A drop in the dollar translates to higher returns for U.S. investors owning international investments. In local currencies, the MSCI EAFE dropped 0.5% in Q2, thus underperforming the domestic market. Despite the effects of currency, many of the trends that took place in the U.S. also occurred overseas. Growth stocks outperformed Value, Mid Cap performed best, and more defensive areas led.

### Improving Trends for Active Managers

How one views the success or failure of active investment managers (versus passive index options) is really a matter of perspective. Baird spends a great deal of time and resources trying to identify environments that may or may not be conducive to active management before assessing success or failure of these managers. It is this combination of evaluating both performance and market conditions that can help to prevent making untimely decisions. On the surface, active managers once again had a mixed quarter relative to their benchmarks. A weighted-average of U.S. and international equity asset classes (2,504 mutual funds, in total) concludes that 49% of mutual funds outperformed their respective benchmark with an average excess return of 4 bp, or 0.04%. It could not get more average than that. Moreover, the success of active managers increased throughout the quarter from 46% outperforming in April when the markets were decidedly positive to 55% outperforming in June when the markets were more volatile (Figure 6). In periods where there are roughly an equal number of winners and losers, investment selection becomes more important.

**Figure 6:** Percent of Mutual Funds Outperforming Benchmarks in 2011



Source: Morningstar; Baird Analysis. See appendix for disclosures.

Results varied on the individual asset class level. This is important when evaluating the performance of your investment options. Sometimes a market benchmark is easier or more difficult to beat, and those trends tend to oscillate over time. For instance, the Large and Mid Growth benchmarks were very difficult to beat in Q2 while Small Cap and International were easier categories to outperform in.

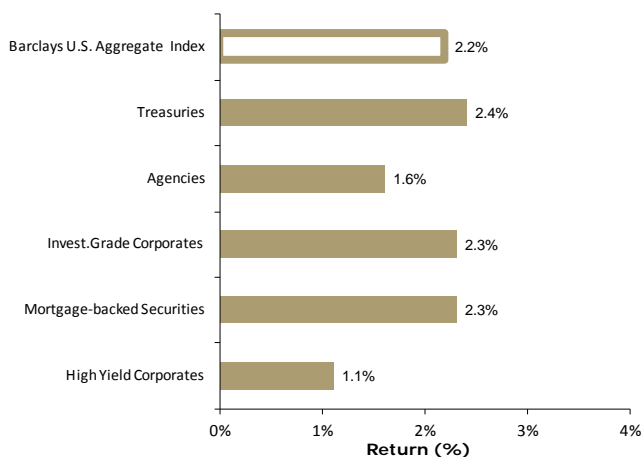
We have written extensively over the past several quarters about why active managers have struggled relative to their benchmarks and noted that it is not all that uncommon given the strength of the market rally. More recently these headwinds have begun to subside and active managers, on the margin, are performing better. In our view, much of the alleviation of these headwinds is due to greater dispersion in the market. A wider range of returns most often means that the attractiveness of an investment opportunity is being viewed based on its fundamental merits, not pure speculation. Evidence of greater dispersion in Q2 includes:

- **Greater Dispersion of Asset Class and Sector Returns.** There was a wide performance gap between asset classes and sectors in Q2. For example, the difference between the best and worst performing U.S. asset class and S&P 500 sector was 420bp and 1380bp, respectively. If these patterns persist over time, a trend will emerge. The success of many active managers heavily depends on correctly identifying longer-term trends.
- **Greater Dispersion of Individual Stock Returns.** Active managers tend to perform best when there is wider dispersion of stock returns. In other words, active managers add more value when the market is evaluating the differences between company fundamentals. This quarter, the distribution of returns was still very tight in Large Cap but broadened out in Small Cap. Two-thirds of the stocks in the S&P 500 performed within a band of 21 percentage points (the 10-year average is 30 percentage points). Conversely, two-thirds of Russell 2000® Index (Small Cap) had returns that landed within a much wider band of 42 percentage points.
- **Greater Dispersion of Country Returns.** The greater differentiation in country returns allowed many international fund managers to add value through country selection. The magnitude to which fund managers were invested in emerging markets was also an important determinant of Q2 performance.

### Solid Showing from Bonds, Especially Municipals

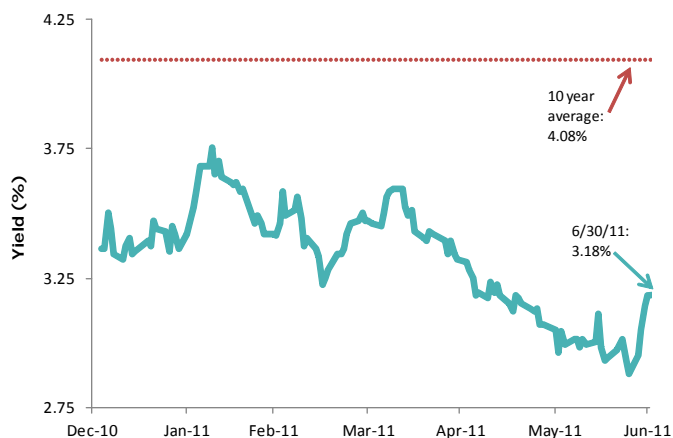
The bond market continued to express strength in Q2 with both taxable and municipal bonds posting solid returns. What was most surprising was a rally in Treasury bonds, which were among the best-performing taxable bond types (Figure 7). Despite historically high valuations and low yields, Treasuries benefited from a flight to quality, primarily those escaping European sovereign debt. This surge in demand for Treasuries pushed yields lower throughout the quarter. As an illustration, Figure 8 details the daily changes in the yield of a 10-year Treasury bond. The June 30 yield of 3.18% is well below the 10-year average yield of 4.08%. Note, yield and prices move in opposite directions, so holding a bond that has a higher yield than what is currently offered makes it more attractive, hence the price increases (all else being equal). High Yield taxable bonds tend to be more closely tied to the direction of the stock market and as such were one of the weaker bond types.

Figure 7: Q2 2011 Domestic Fixed Income Returns by Sector



Source: Bloomberg; Baird analysis.

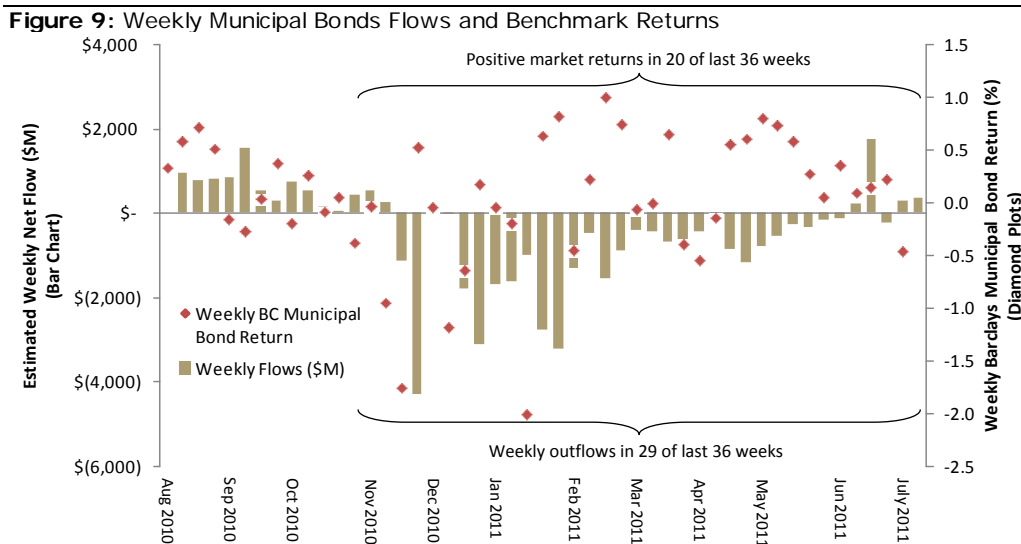
Figure 8: YTD 2011 Changes in 10-Year Treasury Yield



Source: U.S. Treasury.

Municipal bonds bucked the trend displayed in almost every other asset class as risk-seeking behavior continued. Technical factors, namely limited new issuance, have helped bolster returns. In general, riskier bond types (e.g., High Yield, Revenue Bonds), and those with longer maturities and lower credit quality outperformed. The broad Barclays Municipal Bond Index rose 3.9% in Q2. Since most municipal bonds enjoy a tax-exempt status, the taxable equivalent yield was 6.0%. Against the backdrop of a 2.2% gain for taxable bonds (as measured by the Barclays Aggregate Index), this performance was quite impressive.

Many investors have not benefited from the recent strong returns generated by municipal bonds. A flurry of negative headlines chock-full of warnings of mass defaults prompted selling on the behalf of investors. According to our analysis of Morningstar mutual fund data (Figure 9), since concerns started to bubble in November 2010 there have been asset outflows in 29 of the last 36 weeks. Conversely, the threats of mass defaults did not come to fruition and the municipal bond market -- as measured by the Barclays Municipal Bond Index -- has had positive returns in 20 of the last 36 weeks. Evidenced by more recent inflows, investors appear to have taken note. We are not suggesting that the municipal bond market is without risk at this time. Many municipalities are struggling with lower tax bases and have had to cut expenses, though recent data points at the state level suggest that revenue levels are improving. In our view, the probability of select downgrades is higher than defaults at this time. The broader lesson here is that it is difficult and sometimes costly to attempt to time the market, even in the bond market where investors have recently left money on the table.



Source: Morningstar Direct; Baird analysis.

Most bond fund managers experienced a reversal in performance from over/underperforming in Q1 to under/overperforming in Q2 depending on the bond type. Taxable bond funds generally lagged their benchmarks in Q2 largely due to being underweight Treasuries. Municipal bonds generally bested their benchmarks in Q2, especially those maintaining a longer maturity or lower credit quality.

**Suggested Portfolio Activities**

We understand that uncertainty and volatility in the market can cause consternation on the part of investors whom, lacking clear direction, have difficulties implementing portfolio decisions. To that end we compiled some brief suggestions that can help to update a portfolio to current market conditions. There is no one strategy that is applicable to all clients and we suggest having a conversation with your Financial Advisor before taking any action.

- **Rebalance.** This time-tested technique is basic portfolio maintenance, but one that is often overlooked. During the course of the market recovery risky assets have performed much better than more defensive assets. It is a prudent approach to regularly rebalance your portfolio to ensure that the long-term allocations do not deviate far enough to be a concern. This same process can be followed for individual holdings. If you retain conviction in some of the performance laggards, it may be worth adding to those positions, either by new funding or by shifting proceeds from better performing investments.

- **Consider flexible investment strategies.** In uncertain and/or volatile markets there are pitfalls to be avoided and opportunities to exploit. Employing an investment strategy that has the flexibility to navigate across asset classes and security types can be a useful overlay to a portfolio constructed using more traditional investment managers. These can include broad, “go anywhere” options or tactical strategies.
- **Add diversified yield exposure.** In lower return environments yield has historically been an important component of total investment return. Of course, additional yield can be achieved through taking on more credit risk in your bond portfolio, but it can also be achieved by investing in dividend-paying stocks. Company balance sheets are flush with cash and many have been increasing dividend payouts. Of the stocks listed in the S&P 500, more companies have increased their dividends through the first six months of the year since 2004 (the earliest that we have data). We would caution against stretching for the highest yields that often are associated with highest risks. Rather, we recommend adding a mix of yield sources.
- **Diversify your fixed income portfolio.** The end of QE2 and the eventual deleveraging of the U.S. economy mean that the threat of interest rates rising is looming. Most bond portfolios are heavily invested in the U.S., both government and corporate debt. Diversifying a bond portfolio to include additional bond types, as well as international investments may help to make your portfolio less susceptible to changes in interest rates.
- **Incorporate lower correlated investment types.** Diversification isn't simply holding more positions – it is holding investments that act differently from one another. Adding asset classes that have lower correlation to the U.S. stock or bond market can help weatherproof your portfolio. Contact your Financial Advisor for suggestions that may be the most suitable to you.

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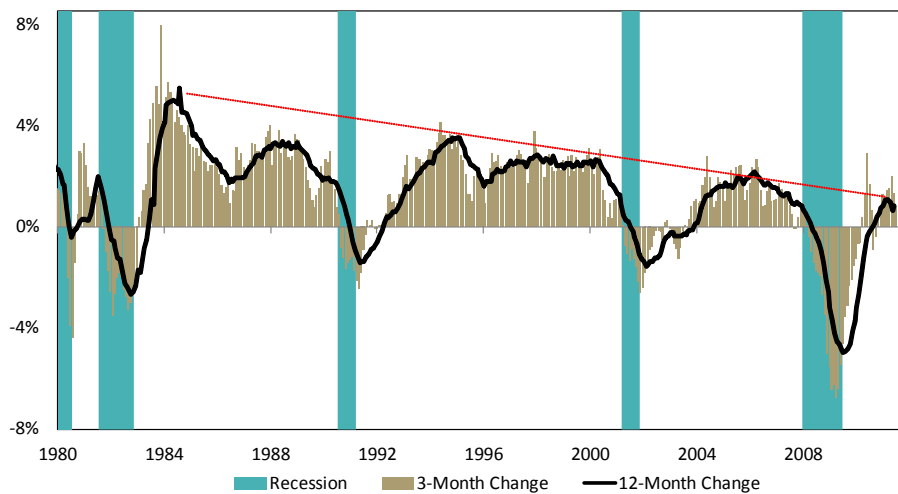
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## Q2 2011 Baird Investment Strategy Outlook (first published July 12, 2011)

With 2011 now half over, let's step back and review from a macro perspective where we have been and where we are going. As 2011 began, the consensus expectation for growth for the year topped 3.5%, with the Federal Reserve's own projections ranging between 3.2% and 4.2%. These expectations were not out of line with the experiences seen coming out of recent recessions, and reflected the view that with the crisis event having passed, economic activity would expand at an accelerated pace to make up for the lost output during the recession.

What has been seen instead has been reported annualized growth of just 1.9% in the first quarter, with growth in the second quarter expected to be similar. The employment picture improved modestly in the first quarter before deteriorating dramatically in the second quarter (Figure 10). Other data showed similar struggles in the second quarter, including various manufacturing surveys done by the regional Federal Reserve banks.

Figure 10: Non-Farm Payroll Employment

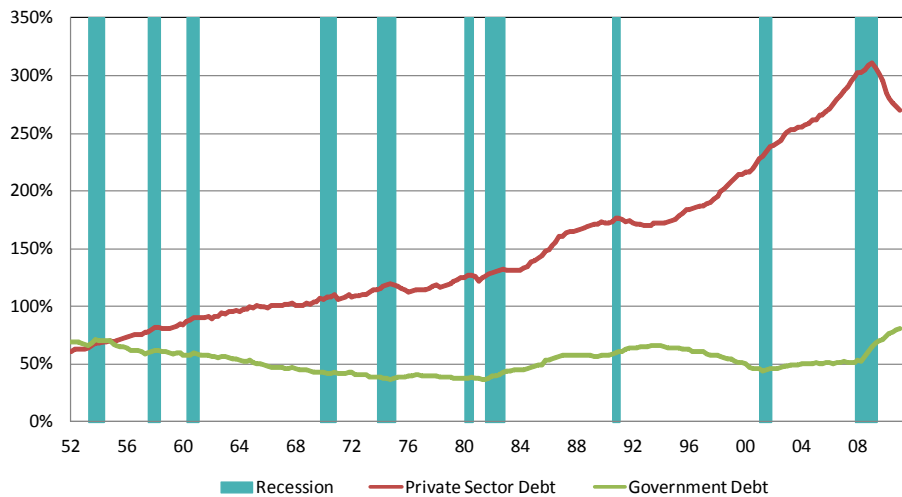


Source: BLS.

Many a forecast has been victim to unforeseen events, such as the Japanese disaster and the flooding and tornadoes seen in the United States. In our view these recent dislocations will likely prove temporary, and the recovery from them may provide some boost to growth in the second half. However, it is unlikely that the bulk of the disappointment in growth in the first half of the year can be attributed to unanticipated developments. There appears to be a lack of recognition of a larger reality.

While on the surface the recent recession and recovery to date has mimicked the experience of past recessions in some respects, the root cause has been significantly different. This has been a balance sheet recession that was years in the making and may be years in recovery. Academic research shows that recovery from financial crises of this sort is slow and uneven. While the 2008 crisis events have passed, secular risks remain high as the problems with debt, both domestically and overseas, are only now beginning to be discussed and addressed. Patience will be required. The key is to view this as an unfolding process, not a discrete and complete event.

The ongoing deleveraging process at the household and business level, policy tools that appear ill-equipped for strengthening the economy, and a mismatch between growth expectations and reality produce an investing environment susceptible to bouts of heightened volatility and macro-related stresses (Figure 11). When these emerge, degrees of risk do not matter as risky assets become highly correlated. The benefits of diversification diminish at precisely the time they are needed most. Our answer to investors struggling with an appropriate stance toward a stock market that enjoys a favorable technical and monetary backdrop but must contend with the high risks due to the global debt bubble is straightforward: preservation of capital trumps other considerations.

**Figure 11:** Debt as a Percentage of GDP

Source: Federal Reserve, BEA.

This starts at the asset allocation level. From a strategic standpoint this means underweighted exposure to stocks and bonds and overweighted exposure to cash. For the average investor we recommend equity exposure of 55%, with 35% exposure to bonds and 10% exposure to cash. Both stock and fixed income investors should not reach for returns, but instead balance risk and return. Periods of volatility can lead to tactical whipsaws as the markets lurch en masse from risk-on to risk-off trades – investors need to keep the bigger picture in mind and not get caught looking at the details, no matter how compelling they may seem in the moment.

### Weight of the Evidence

We continue to rely on the overall weight of the evidence, which is largely neutral. In the current environment the message from the markets (both equity and fixed income) about what is happening matters even more than usual. Fundamental indicators, which offer insight into what should happen, are of less importance. Because short-term technical indicators can be swayed by a single day's market action, investors should focus on the longer-term trend. A break below 1250 on the S&P 500 would indicate that the cyclical equity rally that began over two years ago has lapsed, while a rally to new highs (1365 on the S&P 500) would suggest that the market is looking past the headline risk in the economy and that rally remains intact. Movements within that range may just be noise.

### Federal Policy is Bullish, even Though the Second Round of Quantitative Easing has been Wrapped Up

The Fed will maintain the size of its balance sheet indefinitely, meaning that it will make new purchases of Treasuries as existing holdings mature. While bank lending conditions have improved somewhat, the efforts to induce new lending through QE2 have not been broadly successful. Banks have been willing to keep excess reserves at the Fed or invest them in the stock and commodity markets (the primary beneficiaries of the Fed's largesse) rather than lending them out. We continue to believe that another round of quantitative easing (QE3) will be forthcoming, although the form and timing are uncertain. While it is politically unpalatable for the Fed to discuss it now, a 10% decline in equities and/or a negative quarterly print in GDP could force the Fed's hand. To be clear, this is our view of what will happen, not what should happen.

### Economic Fundamentals are Bearish

Slow and steady economic growth can be good for stocks, but slow growth that has hints of deflation and consistently fails to match expectations can be a headwind for equities.

As we discussed above, the economy is stuck in slow-growth mode while expectations are for average to above-average growth. The longer-term trend in growth appears closer to 2.0% than 3.0%, a view that is not yet widely shared. The next few months may provide insight into just how much of the first-half weakness was temporary, but with business activity slowing, the housing market still in recession, job growth stalling, and governments laying off workers and cutting budgets, the case for sustainable strength in the second half seems beset with opportunities for disappointment.

### Valuations are Neutral

Valuation measures based on expectations are neutral to positive, suggesting that if expectations for earnings are met and the market values these in line with recent history, stocks generally may be somewhat undervalued (although by no means a bargain). However, earnings expectations are coming down and it is dubious to us that the market should value earnings in the current cycle (driven by Fed stimulus and margin expansion more than organic growth) on par with those seen in the past. Moreover, longer-term valuation measures show that generally stocks are fairly valued at best and may tend towards the expensive side.

### Investor Sentiment is Neutral

The pessimism that built up in advance of the late-June rally (which produced the best five-day gains in the indexes in over two years) has dissipated. Optimism, both individual investors and advisory services, has re-entered although it remains shy of the excessive levels that typically cause trouble for the stock market. The VIX volatility index has been subdued of late and even when it rises it hardly suggests that fear has entered the marketplace. Active investment managers have moved cash back into the equity markets. Although overall equity exposure remains shy of the April peak, of concern is the lack of cash on hand at mutual funds: fund managers are not in a position to provide support if stock prices fall, and selling could be exacerbated if redemptions accelerate.

### Seasonal Patterns/Trends are Bearish

The easy gains in the composite cycle are in the past, with the next several quarters suggesting headwinds from a seasonal perspective. Longer-term trends have deteriorated, although the S&P 500 has overcome a down-trend. If the up-trend that began in March 2009 is still intact, the equity indexes should be able to surpass their April peaks. Longer-term momentum trends are generally moving lower, while the price trends for the first half of 2011 are broadly sideways.

### Broad Market Strength is Again Bullish

Strong broad market participation in the rally that closed out the first half provided a marked improvement in the percentage of industry groups in up-trends and carried the sector-level and index-level advance/decline lines to new highs. Strong breadth trends provide important underlying support to the indexes, painting a technical picture that would argue for a breakout above the April index highs. While the secular risks may limit the upside for the indexes, broad market strength may also limit the downside.

### Summary Implications

An elevated risk environment and deterioration in the weight of the evidence has led us to move to recommendation to an underweight position for stocks (leaving us underweight stocks and bonds, and overweight cash). Further, in a high-secular risk environment, capital appreciation may be a less important component to total portfolio return than in the past, while yield, or income, may be more important. While not reducing portfolio quality by chasing yields and overall returns, investors (particular those needing to generate income) should consider balancing yield opportunities across asset classes in their portfolios.

Bruce Bittles (Chief Investment Strategist)

William Delwiche, CMT, CFA (Investment Strategist)

## ROLLING STYLE INDEX RETURNS

ANNUAL RETURNS								
2002	2003	2004	2005	2006	2007	2008	2009	2010
Fixed Income 10.3%	Small Cap Growth 48.5%	Small Cap Value 22.3%	Int'l 14.0%	Int'l 26.8%	Large Cap Growth 11.8%	Fixed Income 5.2%	Mid Cap 40.5%	Small Cap Growth 29.0%
Small Cap Value -11.4%	Small Cap Core 47.3%	Int'l 20.7%	Mid Cap 12.7%	Small Cap Value 23.5%	Int'l 11.6%	Small Cap Value -28.9%	Large Cap Growth 37.2%	Small Cap Core 26.8%
Large Cap Value -15.5%	Small Cap Value 46.0%	Mid Cap 20.2%	Large Cap Value 7.0%	Large Cap Value 22.3%	Small Cap Growth 7.1%	Small Cap Core -33.8%	Small Cap Growth 34.5%	Mid Cap 25.4%
Int'l -15.7%	Mid Cap 40.1%	Small Cap Core 18.3%	Large Cap Growth 5.3%	Small Cap Core 18.4%	Fixed Income 7.0%	Large Cap Value -36.9%	Int'l 32.5%	Small Cap Value 24.5%
Mid Cap -16.2%	Int'l 39.2%	Large Cap Value 16.5%	Large Cap Core 4.9%	Large Cap Core 15.8%	Mid Cap 5.6%	Large Cap Core -37.0%	Small Cap Core 27.1%	Large Cap Growth 16.7%
Small Cap Core -20.5%	Large Cap Value 30.0%	Small Cap Growth 14.3%	Small Cap Value 4.7%	Mid Cap 15.3%	Large Cap Core 5.5%	Large Cap Growth -38.4%	Large Cap Core 26.5%	Large Cap Value 15.5%
Large Cap Core -22.1%	Large Cap Growth 29.8%	Large Cap Core 10.9%	Small Cap Core 4.6%	Small Cap Growth 13.4%	Large Cap Value -0.2%	Small Cap Growth -38.5%	Small Cap Value 20.5%	Large Cap Core 15.1%
Large Cap Growth -27.9%	Large Cap Core 28.7%	Large Cap Growth 6.3%	Small Cap Growth 4.2%	Large Cap Growth 9.1%	Small Cap Core -1.6%	Mid Cap -41.5%	Large Cap Value 19.7%	Int'l 8.2%
Small Cap Growth -30.6%	Fixed Income 4.1%	Fixed Income 4.3%	Fixed Income 2.4%	Fixed Income 4.3%	Small Cap Value -9.8%	Int'l -43.1%	Fixed Income 5.9%	Fixed Income 6.5%

QUARTERLY RETURNS			
Q3 2010	Q4 2010	Q1 2011	Q2 2011
Int'l 16.6%	Small Cap Growth 17.1%	Small Cap Growth 9.2%	Fixed Income 2.3%
Mid Cap 13.3%	Small Cap Core 16.2%	Small Cap Core 7.9%	Int'l 1.8%
Large Cap Growth 13.0%	Small Cap Value 15.4%	Mid Cap 7.6%	Large Cap Growth 0.7%
Small Cap Growth 12.8%	Mid Cap 13.0%	Small Cap Value 6.6%	Mid Cap 0.4%
Large Cap Core 11.3%	Large Cap Growth 11.8%	Large Cap Value 6.4%	Large Cap Core 0.1%
Small Cap Core 11.3%	Large Cap Core 10.8%	Large Cap Growth 6.0%	Large Cap Value -0.5%
Large Cap Value 10.1%	Large Cap Value 10.5%	Large Cap Core 5.9%	Small Cap Growth -0.6%
Small Cap Value 9.7%	Int'l 6.7%	Int'l 3.5%	Small Cap Core -1.6%
Fixed Income 2.5%	Fixed Income -1.3%	Fixed Income 0.4%	Small Cap Value -2.7%

Source: Russell, MSCI, Barclays Capital, Standard & Poors

Large Cap Core represented by S&P 500 Index which includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Large Cap Growth represented by Russell 1000 Growth Index which measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. Large Cap Value represented by Russell 1000 Value Index which measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. Mid Cap represented by Russell Mid Cap Index which measures the performance of the 800 smallest companies of the Russell 1000 Index, which represent approximately 25% of the total market capitalization of the Russell 1000 Index. Small Cap Core represented by Russell 2000 Index which measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index. Small Cap Growth represented by Russell 2000 Growth Index which measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values. Small Cap Value represented by Russell 2000 Value Index which measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. Fixed Income represented by Barclays Capital Aggregate Bond Index which is 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. Int'l is represented by The MSCI EAFE Index which is an international index measuring market performance of 21 countries in Europe, Australasia, and the Far East. Indices are unmanaged and are used to measure and report performance of various sectors of the market. Past performance is no guarantee of future results and diversification does not ensure against loss. Direct investment in indices is not available.

## ROLLING ECONOMIC SECTOR RETURNS

ANNUAL RETURNS								QUARTERLY RETURNS			
2003	2004	2005	2006	2007	2008	2009	2010	Q3 2010	Q4 2010	Q1 2011	Q2 2011
Information Technology 50.9%	Energy 32.8%	Energy 33.5%	Telecomm Service 37.2%	Energy 32.0%	Consumer Staples -16.6%	Information Technology 61.8%	Consumer Discretionary 30.1%	Telecomm Service 20.2%	Energy 22.3%	Energy 16.9%	Health Care 6.9%
Consumer Discretionary 38.2%	Utilities 23.6%	Utilities 15.2%	Utilities 21.7%	Materials 26.3%	Health Care -23.4%	Materials 53.2%	Industrials 27.3%	Materials 18.3%	Materials 19.4%	Industrials 8.7%	Consumer Staples 5.6%
Materials 37.0%	Industrials 18.4%	Health Care 8.3%	Energy 21.6%	Utilities 17.5%	Utilities -28.5%	Consumer Discretionary 46.6%	Materials 25.3%	Consumer Discretionary 15.4%	Industrials 13.6%	Health Care 6.7%	Utilities 5.1%
Industrials 32.7%	Telecomm Service 18.1%	Financials 6.4%	Materials 20.7%	Information Technology 15.1%	Telecomm Service -33.3%	Industrials 21.8%	Energy 21.8%	Industrials 13.7%	Consumer Discretionary 13.5%	Materials 5.6%	Consumer Discretionary 3.3%
Financials 32.6%	Materials 17.1%	Industrials 6.0%	Financials 19.7%	Consumer Staples 14.1%	Energy -37.2%	Health Care 21.8%	Telecomm Service 17.8%	Energy 13.1%	Information Technology 11.4%	Consumer Discretionary 4.8%	Telecomm Service 2.4%
Utilities 26.3%	Financials 13.8%	Consumer Staples 4.5%	Consumer Discretionary 16.4%	Industrials 12.3%	Consumer Discretionary -38.7%	Energy 17.9%	Consumer Staples 14.4%	Information Technology 12.4%	Financials 11.1%	Telecomm Service 4.4%	Information Technology -1.3%
Energy 26.0%	Consumer Discretionary 13.7%	Materials 4.2%	Industrials 15.2%	Telecomm Service 10.1%	Industrials -39.8%	Consumer Staples 15.7%	Financials 13.6%	Utilities 12.0%	Telecomm Service 7.0%	Information Technology 4.4%	Industrials -1.3%
Health Care 20.0%	Consumer Staples 9.5%	Information Technology 2.2%	Consumer Staples 15.1%	Health Care 7.9%	Information Technology -42.9%	Financials 14.4%	Information Technology 12.8%	Consumer Staples 10.8%	Consumer Staples 6.4%	Utilities 4.1%	Materials -1.5%
Consumer Staples 14.5%	Health Care 4.2%	Telecomm Service -2.6%	Information Technology 8.9%	Consumer Discretionary -11.7%	Materials -46.8%	Telecomm Service 12.7%	Utilities 7.3%	Health Care 8.6%	Health Care 5.1%	Financials 3.5%	Financials -5.0%
Telecomm Service 8.2%	Information Technology 1.4%	Consumer Discretionary -4.2%	Health Care 6.8%	Financials -17.8%	Financials -49.8%	Utilities 12.5%	Health Care 6.0%	Financials 5.4%	Utilities 2.2%	Consumer Staples 3.1%	Energy -5.1%

Source: Vestek

Global Industry Classification Standard (GICS) consists of 10 sectors aggregated up from 23 Industry Groups, 59 Industries, and 123 Sub-industries covering almost 6,000 companies globally. GICS sector returns based on the Russell 3000 Index. Energy Sector comprises companies whose businesses are dominated by: construction or provision of oil rigs; drilling equipment & other energy-related service & equipment; or exploration, production, marketing, refining &/or transportation of oil & gas products, coal & other consumable fuels. Materials Sector: manufacture chemicals, constructions materials, glass, paper, forest products & related packaging products, & metals; minerals & mining companies, including producers of steel. Industrials Sector: manufacture & distribution of capital goods, provision of commercial services & supplies & the provision of transportation services. Consumer Discretionary Sector: a manufacturing segment (automotive, household durable goods, textiles & apparel, & leisure equipment) & services segment (hotels, restaurants & other leisure facilities, media production & services & consumer retailing & services). Consumer Staples: manufacture & distribute food, beverages & tobacco & produce non-durable household goods & personal products. Health Care Sector: manufacture health care equipment & supplies or provide health care related services; research, development, production, & marketing of pharmaceuticals & biotechnology products. Financial Sector: banking, mortgage finance, consumer finance, specialized finance, investment banking & brokerage, asset management & custody, corporate lending, insurance & financial investment, & real estate. Information Technology Sector: software development or information technology consulting & services; manufacturers & distributors of communications equipment, computers & peripherals, electronic equipment & related instruments, & semiconductors. Telecomm Services Sector: communications services primarily through a fixed-line, cellular, wireless, high bandwidth &/or fiber optic cable network. Utilities Sector: electric, gas, or water utilities; independent producers &/or distributors of power. Past performance is not indicative of future results and diversification does not ensure against loss.

## APPENDIX – IMPORTANT DEFINITIONS

### Mutual Fund Style Universe

Style-specific universe of mutual funds as categorized by Morningstar. Number of funds in each category as of June 30, 2011: 430 for Large Growth, 406 for Large Core, 310 for Large Value, 220 for Mid Growth, 120 for Mid Core, 110 for Mid Value, 223 for Small Growth, 178 for Small Core, 101 for Small Value, 408 for International, 105 for Short-Term Taxable, 308 Intermediate Term, 61 for Short-Term Tax Exempt, and 75 for Intermediate Tax Exempt.

**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. For a prospectus, contact your Baird Financial Advisor. Please read the prospectus carefully before investing.**

### Equity Styles

**Large Core:** equity securities of large capitalization (generally \$7 billion plus market cap) companies having growth and value characteristics. Based upon the S&P 500 Index.

**Large Growth:** 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). Based upon the Russell 1000<sup>®</sup> Growth Index.

**Large Value:** 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). Based upon the Russell 1000<sup>®</sup> Value Index.

**Mid Core:** equity securities of middle capitalization (\$2-7 billion plus market cap) companies having growth and value characteristics. Based upon the Russell Midcap<sup>®</sup> Index.

**Mid Growth:** equity securities of middle capitalization (\$2-7 billion plus market cap) companies having growth stock characteristics (high price to earnings, high return on equity and low dividend yield). Based upon the Russell Midcap<sup>®</sup> Growth Index.

**Mid Value:** equity securities of middle capitalization (\$2-7 billion plus market cap) companies having growth stock characteristics (high price to earnings, high return on equity and low dividend yield). Based upon the Russell Midcap<sup>®</sup> Value Index.

**Small Core:** equity securities of small capitalization (<\$2 billion plus market cap) companies having growth and value characteristics to minimize the risk of a style being out of favor. Small capitalization stocks may be subject to additional risks including illiquidity. Based upon the Russell 2000<sup>®</sup> Index.

**Small Growth:** equity securities of small capitalization (<\$2 billion plus market cap) companies having growth stock characteristics (high price to earnings, high return on equity and low dividend yield). Small capitalization stock may be subject to additional risks including illiquidity. Based upon the Russell 2000<sup>®</sup> Growth Index.

**Small Value:** equity securities of small capitalization (<\$2 billion plus market cap) companies having value stock characteristics (low forecasted price-to-earnings ratio, low price-to-book ratio, high dividend yield). Small capitalization stocks may be subject to additional risks including illiquidity. Based upon the Russell 2000<sup>®</sup> Value Index.

**International:** a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the US & Canada, consisting of 21 developed market country indices. Based upon the MSCI EAFE Index.

### S&P and Russell Domestic Equity Benchmarks

**S&P 500 Index:** A representative sample of 500 leading companies in leading industries of the U.S. economy. Considered a large-cap index.

**Russell 3000<sup>®</sup> Index:** Measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market. A broad market index.

**Russell Top 50<sup>®</sup> Index:** Measures the performance of the 50 largest companies in the Russell 3000<sup>®</sup> Index, representing approximately 40% of the total market capitalization of the Russell 3000<sup>®</sup> Index. A mega-cap index.

**Russell Top 200<sup>®</sup> Index:** Measures the performance of the 200 largest companies in the Russell 1000<sup>®</sup> Index, which represents approximately 68% of the total market capitalization of the Russell 1000<sup>®</sup> Index. A large-cap index.

**Russell 1000<sup>®</sup> Index:** Measures the performance of the 1,000 largest companies in the Russell 3000 Index, which represents approximately 92% of the total market capitalization of the Russell 3000<sup>®</sup> Index. A large-cap index.

**Russell 1000<sup>®</sup> Growth Index:** Measures the performance of those Russell 1000<sup>®</sup> Index companies with higher price-to-book ratios and higher forecasted growth values. A large-cap index.

**Russell 1000<sup>®</sup> Value Index:** Measures the performance of those Russell 1000<sup>®</sup> Index companies with lower price-to-book ratios and lower forecasted growth values. A large-cap index.

**Russell Midcap<sup>®</sup> Index:** Measures the performance of the 800 smallest companies of the Russell 1000<sup>®</sup> Index, which represent approximately 31% of the total market capitalization of the Russell 1000<sup>®</sup> Index. A mid-cap index.

**Russell Midcap<sup>®</sup> Growth Index:** Measures the performance of those Russell Midcap<sup>®</sup> Index companies with higher price-to-book and higher forecasted growth values. The stocks are also member of the Russell 1000<sup>®</sup> Index. A mid-cap index.

**Russell Midcap<sup>®</sup> Value Index:** Measures the performance of those Russell Midcap companies with lower price-to-book and lower forecasted growth values. The stocks are also member of the Russell 1000<sup>®</sup> Index. A mid-cap index.

**Russell 2000<sup>®</sup> Index:** Measures the performance of the 2,000 smallest companies in the Russell 3000<sup>®</sup> Index, which represent approximately 10% of the total market capitalization of the Russell 3000<sup>®</sup> Index. A small-cap index.

**Russell 2000<sup>®</sup> Growth Index:** Measures the performance of those Russell 2000<sup>®</sup> Index companies with higher price-to-book ratios and higher forecasted growth values. A small-cap index.

**Russell 2000<sup>®</sup> Value Index:** Measures the performance of those Russell 2000<sup>®</sup> Index companies with lower price-to-book ratios and lower forecasted growth values. A small-cap index.

**Russell Microcap<sup>®</sup> Index:** Measures the performance of the microcap segment of the U.S. equity market. It makes up less than 3% of the U.S. equity market. It includes 1000 of the smallest securities in the small-cap Russell 2000<sup>®</sup> Index based on a combination of their market cap and current index membership and it includes the next 1,000 securities. A micro-cap index.

The Russell Indices are a trademark of the Frank Russell Company. Russell<sup>®</sup> is a trademark of the Frank Russell Company.

### MSCI International Equity Benchmarks

**MSCI EAFE Index:** 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. An international index.

**MSCI Emerging Markets Index:** 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: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey. An international index.

**MSCI Europe Index:** A free float-adjusted market capitalization index that is designed to measure developed market equity performance in Europe. As of June 2006, the MSCI Europe Index consisted of the following 16 developed market country indices: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom. An international index.

**MSCI Country Indices:** 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<sup>®</sup>), 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.

**MSCI Pacific ex Japan Index:** A free float-adjusted market capitalization index designed to measure equity market performance in the Pacific region, minus Japan. As of June 2006, the MSCI Pacific ex Japan Index consisted of the following 5 Developed Market countries: Australia, Hong Kong, New Zealand, and Singapore. An international index.

**MSCI EAFE Small Cap Index:** Target 40% of the eligible Small Cap universe within each industry group, within each country. MSCI defines the Small Cap universe as all listed securities that have a market capitalization in the range of USD200-1,500 million. An international index.

**MSCI Value and Growth Indices:** Cover the full range of developed, emerging and All Country MSCI Equity Indices. As of the close of May 30, 2003, MSCI implemented an enhanced methodology for the MSCI Global Value and Growth Indices, adopting a two dimensional framework for style segmentation in which value and growth securities are categorized using different attributes - three for value and five for growth including forward looking variables. The objective of the index design is to divide constituents of an underlying MSCI Standard Country Index into a value index and a growth index, each targeting 50% of the free float adjusted market capitalization of the underlying country index. Country Value/Growth indices are then aggregated into regional Value/Growth indices. Prior to May 30, 2003, the indices used Price/Book Value (P/BV) ratios to divide the standard MSCI country indices into value and growth indices. Includes the MSCI EAFE Value and Growth Indices. International indices.

### Barclays Capital Fixed Income Benchmarks

**Barclays Capital Aggregate Bond Index:** 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.

**Barclays Capital Muni Bond Index:** 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.

**Barclays Capital U.S. High Yield Bond Index:** 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.

**Barclays Intermediate Government/Credit Bond Index:** The Government Index includes treasuries (i.e., public obligations of the U.S. Treasury that have remaining maturities of more than one year) and agencies (i.e., publicly issued debt of U.S. Government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the U.S. Government. The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements. This index is the intermediate maturity component of the U.S. Government/Credit index.

**Barclays 1-3 Yr Government/Credit Bond Index:** The Government Index includes treasuries (i.e., public obligations of the U.S. Treasury that have remaining maturities of more than one year) and agencies (i.e., publicly issued debt of U.S. Government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the U.S. Government. The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements. This index is the 1-3 Yr component of the U.S. Government/Credit index.

### Citigroup Benchmarks

**Citigroup 3-month T-bill Index:** This index measures monthly return equivalents of yield averages that are not marked to market. The Three-Month Treasury Bill Indexes consist of the last three three-month Treasury bill issues.

### Dow Jones Benchmarks

**Dow Jones-UBS Commodity Index:** 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.

### Wilshire Benchmarks

**Wilshire Global REIT Index:** Measures global publicly traded Real Estate Investment Trusts. The Wilshire Global REIT Index (WGREIT) is a subset of the Wilshire Global Real Estate Securities Index (WGRESI). The global index is an expansion of the original U.S. index, developed in 1991.

### GICS

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## APPENDIX – IMPORTANT DISCLOSURES

### 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.

### ADDITIONAL INFORMATION ON COMPANIES MENTIONED HEREIN IS AVAILABLE UPON REQUEST.

The Dow Jones Industrial Average, S&P 500, S&P 400, MSCI EAFE, Barclays Capital U.S. Aggregate Benchmark, Barclays Capital Municipal Bond Benchmark, Russell 1000® Index, Russell Midcap® Index, Russell 2000® Index, and Russell 3000® Index 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.

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