



BAIRD INVESTMENT DIGEST

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Inside

INVESTMENT OUTLOOK

U.S. equity markets are poised for further gains.

QUEST FOR YIELD

Investments offering the potential to boost yield.

ASSET ALLOCATION

Taking a dynamic approach to diversify your investments.

YEAR-END STRATEGIES

Position your portfolio for the coming year.

INVESTOR TOOLS

A planning calendar to keep you on track.

Thinking Sport

The gully was formidable terrain. A glance at her watch confirmed what she already intuitively knew; she had lost valuable time. And she had limited navigation options from this point forward. Thumbing her map and taking a bearing from her compass, she considered them.

The map didn't seem to fully reflect the gully's depth. It was marked as passable on the far side, but she couldn't definitively tell where she could pass. If she worked the edge to the north, it seemed that she could easily pass around the gully about a mile up. But that would cost valuable time to the next control point. Sighing, she made her decision and began descending into the gully. "No guts, no glory," she said quietly to herself as she accelerated past the boulders, all the time searching the far wall for passable terrain.

In a world of handheld GPS devices and smartphones, the sport of orienteering stands out. It involves a timed race between a number of selected control points without the assistance of electronic navigation devices. The challenge is that the route between those points isn't specified and the orienteer must choose a route. Originally a training exercise for 19th century officers at the Swedish Military Academy Karlberg, orienteering has become an internationally recognized sport, with national federations in 67 countries. The O-Ringen orienteering meets, held annually since 1965 in Sweden, attract more than 15,000 competitors.

Orienteering's most basic definition is crossing unknown land with only the aid of a map and compass. A lot of investors could sympathize. These last few years, investors have been working through an orienteering competition of their own, navigating challenging conditions as change and uncertainty buffeted the economy and financial markets.

You plan a route through the map of market conditions and expectations. Your personal goals, like control points, are your targets. Your investment horizon – whether for meeting retirement, education or individual goals – establishes the times you need to achieve. You use your financial plan to set the route, taking all of these factors into consideration.

Rarely is there only one route to your goals. Multiple routes are considered based on what is seen on the map. Just as important, the situation may require you to make adjustments and explore alternatives as market conditions evolve.

Ultimately, your financial planning success will be directly attributed to your route selection and ability to adapt to unforeseen changes. Like orienteering, it's a thinking sport. Your Baird Financial Advisor is there to assist you in navigating through diverse, unfamiliar and unpredictable markets, helping you develop a financial plan providing a safer, more secure trail to your investment, financial and, ultimately, life goals.

A column providing a perspective that transcends daily events has appeared on the cover of Baird Investment Digest for more than 30 years.



Bruce Bittles
Chief Investment Strategist

“Despite economic challenges, the U.S. equity markets are poised for further gains.”

Investment Outlook

Fed Takes the Reins

November 10, 2010

Economic growth has slowed from the pace seen earlier this year as the effects of government stimulus have been arguably minimal and the private sector has not been able to pick up the slack. Business investment and inventory rebuilding remain relatively strong, but consumers have neither the ability nor inclination to return to the aggressive spending patterns of years past. Household debt levels have begun to recede, although this may be more a function of defaults than pay-downs. The employment picture has improved somewhat in recent months, but the pace of job creation is only sufficient to prevent further rises in the unemployment rate, not actually bring it meaningfully lower. Moreover, wage growth is at its lowest level in 20 years and disposable incomes could be negatively impacted in coming months as jobless benefits begin to expire. The housing market is still struggling to find its natural equilibrium. Depressed home values are limiting the ability of homeowners to take advantage of record-low mortgage rates and reducing the mobility of the American workforce, as would-be workers cannot easily relocate to take advantage of job opportunities. The fact that the economy continues to struggle suggests that the government should do more.

Fed Shoulders the Load

The results of the mid-term elections are expected to have an impact on the economy and financial markets. The most likely outcome is political gridlock, and that will place the burden of the economy on the shoulders of the Federal Reserve Board. The fact that state, local and federal government will have a check on spending means aggressive fiscal policy will not be available to support the economy. As a result, Fed Chairman Ben Bernanke

has announced the launching of another round of quantitative easing (QE2). The Fed admits that this strategy is an experiment in monetary policy. By definition, the risks are high when a weak dollar policy and the printing press are the tools used to solve the nation's problems. Running the printing presses raises the spectrum of higher rates of inflation and a weaker dollar. The Fed is focused on core CPI (less food and energy). But most of us still drive to work and continue to eat. Already commodity prices are making noise, led by foodstuffs and raw materials. Cotton, corn, sugar, tin, copper and silver prices are hitting multiple-year highs. At the moment, excess capacity in the economy, slow job and wage growth and a very weak housing market are the offset. The largest risk, therefore, is that the economy recovers too quickly, triggering inflation at the consumer level.

Stock Market Outlook Positive in 2011

The financial markets have enjoyed a significant rally since late August, when the Fed first suggested another effort at quantitative easing was possible. Although the Fed's strategy has gathered criticism, history shows the Fed typically gets its way in the long run. In addition to a friendly Fed, the equity markets are also benefiting from strong corporate earnings and technically from a bullish trend and a strong seasonal period lasting well into 2011. The one- and four-year cycles argue for higher prices into early 2011, and the mid-term election cycle shows stocks higher one year later in 17 of the previous 17 examples. The TAPE is also bullish. In a healthy bull market, all areas of the stock market are in harmony with the primary trend. Almost 85% of all S&P industry groups and 95% of all foreign markets are in uptrends. Finally, investor sentiment indicators show optimism rising but a distance from levels considered threatening or extreme.

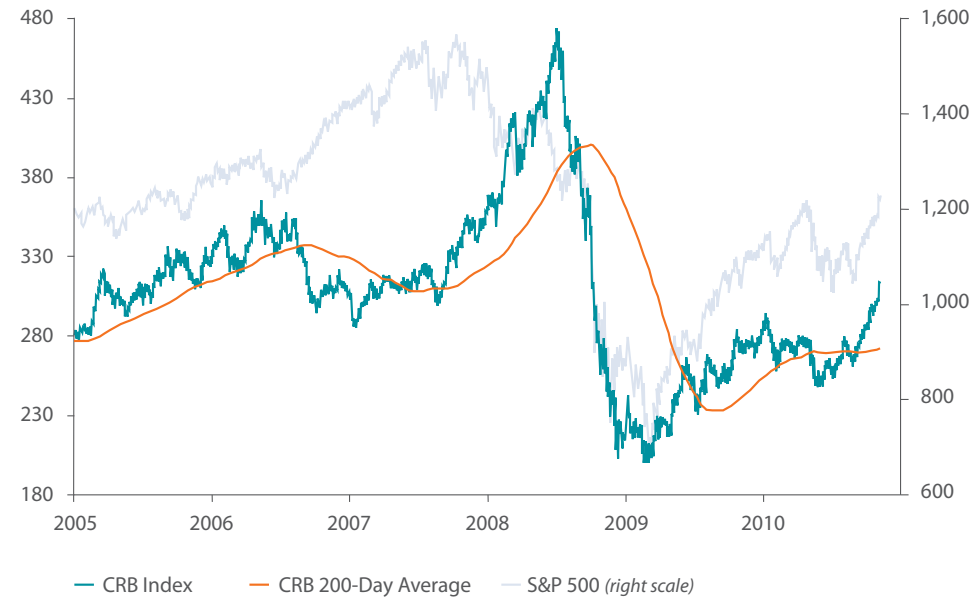
The Bottom Line

Despite economic challenges, the U.S. equity markets are poised for further gains. Money is the life blood of Wall Street, and the Federal Reserve is embarked on a strategy of accommodation. The areas expected to benefit include the Materials, Technology and Industrial sectors and emerging markets. Although we anticipate interest rates to remain low well into next year, investors should concentrate efforts in three- to five-year maturities in high-grade corporate and municipal bonds.

Market Perspective

Bruce Bittles' latest market commentary and a more comprehensive look at investment strategy are available at rwbaird.com on the Insights page, on the Baird OnLine home page or through your Baird Financial Advisor.

Commodity Prices and S&P 500



Data source: The Wall Street Journal

Rising commodity prices are an unintended consequence of Fed policy. A weak economy is offsetting the impact of these price increases.

Index Definitions

The CRB Index: An index based on the prices of 19 economically important commodities.

The S&P 500: A market-cap-based index of 500 domestic large-cap stocks.



Laura Thurow, CFA
Co-Director
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“Yield has become increasingly important to investors, causing them to look beyond traditional sources for income.”

The Quest for Yield

Investments Offering the Potential to Boost Yield

Investment income has always been an important part of the total return for investments: Total Return = Price Appreciation + Income. Typically, investors seek price appreciation from their equity investments and income, or yield, from their fixed income investments. Recently, yield has become increasingly important to investors, causing them to look beyond traditional sources for income.

Following the extreme market volatility of 2008 and 2009, many investors have allocated a smaller percentage of their assets to equities and other risk assets, either to position themselves more defensively in the face of uncertainty or to correct an over-allocation to risky assets. However, while investors are taking on less risk, it appears they have not ratcheted down their return objectives, which has increased the need for yield. Additionally, most would agree that the outlook for economic growth, and as such stock price appreciation, in the decade to come is more muted than in the recent past. Whatever the driver, it is clear that yield is on the mind of many investors.

Key Considerations in the Quest for Yield

There are many ways to achieve yield in investment portfolios, and we will discuss several of these. First, though, as investors seek higher yield through traditional and nontraditional approaches, it is important to keep two key considerations in mind.

Real vs. Nominal Yield: The yield statistic published for most investment vehicles is a nominal yield, which includes both real yield and inflation. For example, a 3% yield on a Treasury bond in a no-inflation environment is similar to a 5% yield when inflation is 2%. For perspective, the current real yield of 1.4% (as of September 2010) is below the historical average of 3.7%, but still well within the typical range. In our view, most investors have not adjusted their expectations for the low-inflation environment.

Risk/Return Trade-Off: As investors pursue yield opportunities, taking the risk/return trade-off into consideration is paramount. Whether the search for increased yield is driven by a desire to offset lower expected price appreciation or by unrealistic expectations given low inflation, investors must be aware that higher-yielding investments are often characterized by higher volatility and risk.

Yield Opportunities

There are several investment vehicles that offer the potential for income instead of, or in addition to, the potential for price appreciation. These include more traditional investment vehicles such as bonds and dividend-paying stocks, as well as less traditional vehicles such as master limited partnerships (MLPs) and real estate investment trusts (REITs).

As the chart on page 5 illustrates, there are differing levels of opportunity relative to historical yields. For example, yields for Treasury, investment-grade and high-yield bonds are currently below the 10-year historical averages, indicating less opportunity. Conversely, current yields are at or above historical averages for preferred stocks, MLPs and dividend-paying stocks.

Each of these vehicles has a unique structure and a unique risk/return trade-off, as described below. As such, investors can benefit from having a diversified portfolio of yield-focused investments, with investments across several of these categories.

Bonds

Bonds are issued by a government, company or institution. In exchange for receiving a fixed principal up front, issuers agree to pay back principal plus interest over the life of the bond. Bonds can be attractive investments for investors who have particular income needs and/or a set time period for investment. Bonds are often thought of as lower-risk securities, but the risk an investor takes is determined by the creditworthiness of the issuer, which can change over time, and inflation. Typically, bonds with higher yields (corporates, asset-backed, non-agency mortgage-backed) have higher risk, including risk to principal, than those with lower yields (Treasury, agencies).

Preferred Stocks

Preferred stocks are hybrid securities with characteristics of both debt and equity. Similar to bonds, preferreds are issued with a fixed par value and pay a dividend based on a percentage of par. Preferred shareholders have priority over common stockholders in the event of liquidation, but are subordinate to debt, do not have voting

rights and generally have less opportunity for price appreciation. Preferred securities come in a variety of structures, including fixed rate (often callable), adjustable rate, convertible and trust preferred (have a set maturity date). Note that dividends are not guaranteed. Additionally, the current yield shown on the chart reflects the inclusion of both investment-grade and noninvestment-grade issues.

Dividend-Paying Stocks

Public corporations have choices on how to best utilize their earnings: paying down debt, reinvesting in growth opportunities, buying back shares and paying dividends. More mature companies often choose to pay a dividend, and certain sectors, particularly Consumer Staples, Telecommunication and Utilities, are predisposed to paying dividends. While a dividend has often served as a positive indicator of earnings stability, it does not guarantee a positive total return. Additionally, dividends are not guaranteed and equity investors risk losing their entire investment.

Master Limited Partnerships (MLPs)

MLPs are limited partnerships traded on public exchanges. They typically fall into three broad categories related to oil, gas and other natural resources: pipelines, exploration and production, or propane retailers. Given the focus on commodities, MLPs typically have low correlation with U.S. equities. MLPs are required to pay out the majority of their income in quarterly distributions and can be subject to K-1 tax treatment to avoid the double taxation on income earned for partners.

Real Estate Investment Trusts (REITs)

REITs offer investors an opportunity to invest in physical real estate assets with lower capital requirements and higher liquidity. The trusts raise money to invest in real estate assets, manage those assets and distribute the income to shareholders. There are public REITs (traded on stock exchanges) and private REITs (private placements). REITs are required to pay out 90% of their taxable income to investors in the form of dividends, which are treated as ordinary income because the REITs generally do not pay taxes at the corporate level.

Reassessing Your Yield

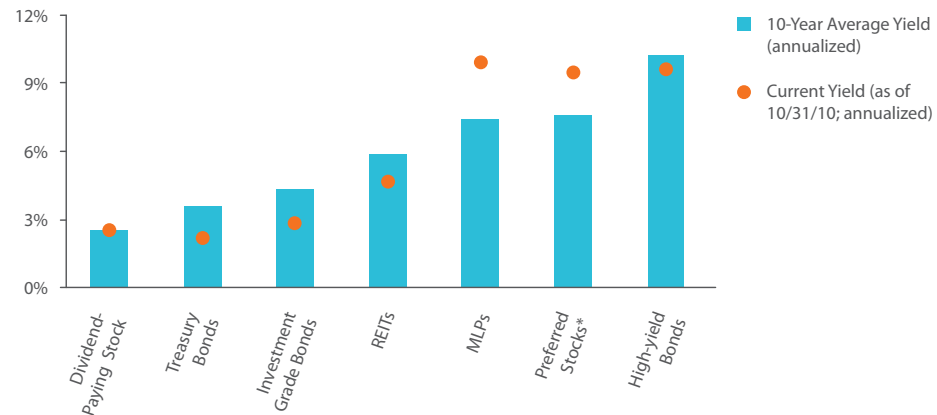
If you are interested in increasing the yield of your portfolio, talk with your Financial Advisor about investments that may be appropriate for your goals and risk tolerance.

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See important disclosures on page 7.

Yield Opportunities
Current Yield vs. Historical Yield



*Preferred Stocks is a 5-year average yield (benchmark inception was 2003).

Market indices used as asset class proxies for illustrative purposes. See definitions for detail.

- Market indices used in chart, from left to right:
- Russell 1000® Value: An unmanaged common stock index that is generally representative of the large-cap value market.
- BarCap US Treasury: An unmanaged index made up of U.S. Treasury securities.
- BarCap US Govt/Corp.: An unmanaged common stock index that is generally representative of the intermediate bond market.
- DJ US Select REIT: A subset of the Dow Jones Wilshire Real Estate Securities Index, which measures U.S. publicly traded Real Estate Investment Trusts.
- Alerian MLP: A float-adjusted, capitalization-weighted composite of the 50 most prominent energy Master Limited Partnerships.
- S&P US Preferred Stock: An index that is generally representative of the U.S. preferred stock market.
- BarCap US Corporate High Yield: Covers the universe of fixed rate, noninvestment-grade debt.



Asset Allocation in Uncertain Times

Taking a Dynamic Approach to Further Diversify Your Investments

Asset allocation establishes the framework of an investor’s portfolio and creates a plan specifically identifying where to invest one’s money. In its most basic form, asset allocation is the decision of how to weight stocks, bonds and cash in a portfolio to provide the potential for the greatest investment return for the amount of risk you’re willing to take. Advocates conclude that proper asset allocation has the potential to increase investment results and lower overall portfolio volatility. Critics argue that the growing interconnectedness of financial markets makes traditional asset allocation less beneficial than it once was. It is Baird’s opinion that both perspectives are correct – asset allocation can lead to better overall results, but the implementation needs to be flexible enough to adapt to changing trends seen in today’s financial market.

The Importance of Asset Allocation

Asset allocation is important in two distinct ways. The first relates to portfolio design. The theory asserts that in any given period, some investment styles will be winners and some will be losers, and that this varies over time. The addition of investment styles that perform differently than the rest of your portfolio (i.e., have a low correlation) can reduce overall portfolio volatility. This is because individual asset classes can be volatile, but in a well-constructed portfolio there will be other investments that partially offset that volatility, both on the upside and downside, thus producing a more stable return pattern.

The second reason asset allocation is important is that it helps investors keep a long-term perspective and avoid knee-jerk reactions. Investors have a tendency to chase the best-performing segments of the market and shun poor-performing areas. Yet, it is incredibly difficult to guess what areas will continue to shine and what the next market leaders will be. Most often, trying to time the market can have perverse consequences and impair investment results.

Adapting in Uncertain Times

A proper asset allocation plan provides a long-term framework to structure a portfolio. Yet, in some environments, value can be added by taking a more active approach to portfolio construction. In the

face of today’s economic uncertainties, Baird’s expectation for stock market returns is somewhat muted. Therefore, we believe that a dynamic asset allocation plan could benefit many clients.

A dynamic asset allocation plan, as opposed to a static asset allocation plan, broadens the investment universe to include options that seek to capitalize on current market opportunities, avoid major pitfalls or reduce portfolio volatility. We consider there to be three major building blocks of a dynamic asset allocation plan: traditional asset allocation, alternative investments and flexible strategies. This adaptive approach reflects evolving opportunities in the marketplace and recognizes the changing conditions that our clients are facing.

- 1. Traditional Asset Allocation.** We believe that a traditional, strategic asset allocation based on one’s risk tolerance and return objectives remains the most important factor in portfolio design. To this end, Baird’s Investment Policy Committee has developed a series of model portfolio allocations using time-tested asset classes. Subject to client suitability, these models can be further enhanced to include alternative investments and flexible strategies.
- 2. Alternative Investments.** The major benefit of alternative investments is the low correlation between these classes and other more traditional asset classes. Lower correlation, or the degree to which two investments perform similarly, can lead to lower overall portfolio volatility. Stated differently, the performance of these options is less dependent on the broad stock and bond markets. We use the term “alternative investments” in a very broad sense to include any nontraditional asset classes. More commonly, this encompasses niche asset classes and absolute return strategies, but may include more sophisticated strategies, such as hedge funds and private equity investments for qualified investors. The goal of combining traditional and alternative methods is to construct a portfolio that has a more favorable risk/reward trade-off and is less susceptible to broad market

Dynamic Asset Allocation Plan



A dynamic asset allocation plan expands the investment universe.

movements. Note that many alternative investments have unique risks that make them unsuitable for some investors.

3. **Flexible Strategies.** During periods where market returns are uneven and the outlook is uncertain, opportunities exist in a broad range of areas. Capitalizing on these opportunities requires recognizing shorter-term trends in the marketplace, which often oscillate between investment types. Therefore, clients may benefit from employing investment options that have a flexible investment mandate or approach. Broad mandate, or “go-anywhere,” investment strategies are not constrained by a specific classification and can invest nearly anywhere. The main objective of a flexible strategy is to combine investment options that serve a specific role with complementary ones that can play any role in a portfolio.

Using a dynamic approach to asset allocation can help weatherproof your portfolio to handle the volatility and uncertainty evident in the current market. As the investment universe continues to expand in these nontraditional areas, we are dedicated to providing more guidance and options for our clients. Baird currently provides due diligence research on more than 140 traditional and nontraditional investment options, and our Financial Advisors have access to thousands more.

Important Disclosures

Past performance does not guarantee future results. Diversification does not ensure against loss.

Investments in commodities expose an investor to potentially high volatility and are generally only suitable for investors with a high tolerance for risk. In a rising interest rate environment, the value of fixed-income securities generally declines and conversely, in a falling interest rate environment, the value of fixed-income securities generally increases. High-yield or high-dividend securities may be subject to market, interest rate or credit risk and should not be purchased solely because of the stated yield or dividend rate.

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In light of the current economic climate, we encourage clients to regularly revisit their asset allocation strategy with their Financial Advisor to ensure their investment portfolio accurately reflects their risk tolerance and goals and is well-positioned to take advantage of the changing opportunities in the global investment marketplace.

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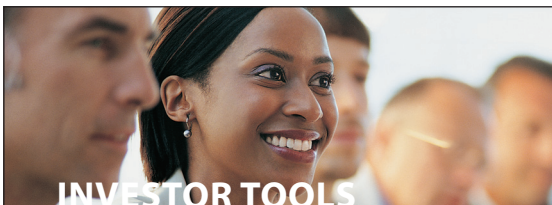
Risks of Alternative Investments

There are several risks associated with alternative investments that may exceed the typical risks associated with traditional investments. Alternative investments can have higher fees, be more complicated and less transparent and be less liquid and less tax-friendly. In addition, they may disappoint in strong up markets, may not diversify risk in extreme down markets and may involve credit risk.

suitable for all investors and is being provided on the basis that you have such knowledge and experience in financial and business matters to be capable of evaluating the merits and risks associated with such information. Further, you should consult with your Financial Advisor prior to engaging in any transaction described in this communication.

Investments such as private investments, hedge funds, MLPs and REITs are complex instruments and are not suitable for all investors. These investments involve risk, are complex, typically illiquid, may not be transferable, may not be as highly regulated as more mainstream investments and may not be listed or traded on any exchange. Investors and their Financial Advisors should conduct their own analysis of a product and its risks, including the risk of total loss of capital.

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Planning Calendar

November 30, 2010

The last day to buy a security and recognize a loss on the sale of a substantially identical security by the end of the year (sale must be December 31).

December 31, 2010

- All deductible expenses and charitable gifts must be paid in order to claim a 2010 tax deduction.
- All gifts to family members and other individuals must be complete in order to be considered gifts in 2010.
- All capital transactions (buying and selling of investments) must be complete in order to be considered a 2010 transaction.
- Required Minimum Distributions from IRAs and other retirement plans must be completed.
- Energy-efficient improvements to a residence must be completed to qualify for the federal tax credit.

January 18, 2011

Fourth-quarter federal estimated tax payments for 2010 are due.

Investment Strategy

The *Market Commentary* by Baird's Chief Investment Strategist, monthly *Investment Strategy Outlook* and quarterly *Market Update* are available at rwbaird.com on the Insights page, on the Baird OnLine home page or through your Financial Advisor.

Year-End Strategies

Position Your Portfolio for the Coming Year

With the uncertainty around 2011 tax law, tax planning for 2010 is more complicated than ever. As the year draws to a close, you should discuss the following tax and other financial matters with your Baird Financial Advisor and your tax consultant.

- Review your capital gain position for the year to see if there are opportunities to net capital gains against capital losses.
- When selling stocks at a loss, beware of the wash sale rules, which prevent the deduction of losses when a "substantially identical" position is bought shortly before or after the sale.
- For 2010, the 5% capital gain rate for lower-income taxpayers is lowered to 0%. Those taxpayers may wish to take advantage of that by selling stock before year-end.
- Tax law for 2011 includes an increase in tax rates on ordinary income, capital gains and dividends, unless Congress acts. While there is much speculation on whether this will change, you may want to consider accelerating income into 2010 to lock in the current tax rates.
- Likewise, you may also wish to consider deferring some deductible expenses into 2011 if you anticipate that the higher tax rates next year will be maintained.
- In order to take advantage of the two-year deferral on recognizing Roth conversion income, you must convert by December 31, 2010. Conversions after that date are fully taxable in the year of conversion.
- Unlike 2009, Required Minimum Distributions from retirement plans have not been waived for 2010. In order to avoid a large penalty, be sure to make any required retirement plan distributions for 2010 before December 31.

ADDITIONAL INFORMATION ON COMPANIES MENTIONED HEREIN IS AVAILABLE UPON REQUEST.

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