Investing in Health Care in the Age of COVID-19

This is an edited version of a June 23, 2020 Q&A with Baron Health Care Fund Portfolio Manager Neal Kaufman and Assistant Portfolio Manager Josh Riegelhaupt. To access the full recording, please dial 866-595-5357, passcode 0907534#.

Key Discussion Points

Introduction
Fund performance

The Health Care Investment Climate
General thoughts on the pandemic and its impact on the markets

Baron Health Care Fund
Positioning the Fund, investment themes, new names, differentiators

Introduction

Baron Health Care Fund launched a little over two years ago and in that time, has achieved some impressive numbers. Year-to-date through June 22, 2020, the Fund is up 13.62%, outperforming the Russell 3000 Healthcare Index by 11.8%. In 2019, the Fund was up 35.57%, outperforming its benchmark by 13.46%. PM Neal Kaufman and APM Josh Riegelhaupt have managed the Fund since inception.

Health Care Investment Climate

Neal Kaufman: We've just gone through phase one of the pandemic: the lockdown phase to avoid overwhelming the health care system. During that phase, hospitals cancelled or deferred elective procedures to make beds available for patients with COVID-19, which had a negative impact on hospital profits as elective procedures typically generate high profit margins. The cancellation of these procedures also negatively impacted medical device companies, which sell products used in hospital and outpatient procedures.

Academic labs temporarily shut down as well, which hurt sales and earnings of life sciences companies that sell products used in these labs. Clinical trials temporarily halted, which hurt delayed trial timelines and impacted the contract research organizations (CROs) that run the trials for biopharmaceutical customers.

On the positive side, managed care companies have benefited temporarily from lower costs since they are not needing to pay for these procedures. Telemedicine has seen strong demand, and we believe it will become more widely accepted as a way to treat patients after the pandemic subsides. According to a recent McKinsey analysis, as much as $250 billion of U.S. health care spending could be virtualized, or roughly 20% of all Medicare, Medicaid, and commercial spend across outpatient office and home health. Companies that provide remote monitoring technology are also seeing increases in utilization. Finally, we think drug pricing reform is off the table for now as the political focus will likely shift to the expansion of insurance coverage due to the pandemic.

The need for antibody testing as an important tool to ascertain who has had the virus and recovered has caused a ramp in testing capacity, as there is a presumption that people with antibodies are likely to be immune for some period of time. Biopharmaceutical companies have shifted resources to the development of therapies and vaccines. Ultimately the biopharmaceutical industry will be part of the solution to the current pandemic.

So where do things stand now? Inpatient and outpatient procedures have been on the rise as states reopen. We're still not at pre-shutdown levels, but the trends are headed in the right direction. The increase in the number of COVID-19 cases in certain states is concerning, but we know a lot more today about the virus and how to prevent the spread than we did a few months ago. Doctors are also much better at treating patients today than a few months ago. So even though we have some concerns about virus numbers and the potential for a second wave, we don't see a return to a total shutdown.

Baron Health Care Fund

In light of current conditions in the health care market, how are you positioning the portfolio?

Given the volatility in the market and the unique impact this health care crisis is having on different segments o f the health care industry, we have been continuously monitoring our holdings and speaking with the executives at all of our portfolio companies. We're focused on ensuring that our companies have sufficient balance sheet strength and liquidity to weather an economic downturn. Other than that, we are not changing much. Rather, we continue to invest in the themes that we believe have the best long-term growth potential in the space.

During the pandemic, we've seen robust capital markets activity. Some of our companies have done equity offerings to ensure they have the cash on hand to continue to invest for growth. IPO activity has been strong within the sector as well. While we own a number of investments that will benefit from providing solutions to COVID-19, we're not investing in companies that are dependent on a COVID-19-related outcome. For example, we own companies that sell diagnostics for COVID-19 like **Abbott Laboratories (ABT)** and **Roche Holding AG (RHHBY)**, and others that are developing vaccines like **Sanofi (SNY)**, and **AstraZeneca PLC (AZN)** but we don't own these stocks because we're making a bet on their success or failure with COVID-19.

Tell us about some of your investment themes and how they may or may not be impacted by the pandemic.

Remote monitoring One of our investment themes benefiting from the COVID-19 pandemic is remote monitoring. **DexCom, Inc. (DXCM)**, the market leader in continuous glucose monitoring products for diabetics, is a good example. Hospitals are using its products to remotely monitor blood glucose levels of COVID-19 patients, for whom diabetes is a co-morbidity. **Masimo Corporation (MASI)** is the leader in pulse oximetry technology, a key tool in the current pandemic, and it offers a range of remote monitoring solutions that have also seen their usage surge. **Intuitive Surgical, Inc. (ISRG)** has a robotic surgery platform that also enables key opinion leaders to provide long distance live case support coaching and proctoring. We are also monitoring several private companies in this theme that are likely to come public soon.

Life sciences tools providers Another key theme is life sciences tools providers. We like these companies because they are “picks and shovels” plays on the growth of the life sciences industry, which means they are likely to benefit regardless of the success of any particular biopharmaceutical company, drug, or vaccine. For example, **West Pharmaceutical Services, Inc. (WST)** makes packaging components for vaccines and injectable drugs. Its products have specialized coatings that prevent contamination and have to go through rigorous testing and FDA review. We think West’s products are likely to be used to package many of the COVID-19 vaccines that will be coming out. Other examples are **Bio-Techne Corporation (TECH),** which sells antibodies and proteins used in life sciences research, and **Thermo Fisher Scientific Inc. (TMO)**, the largest life sciences tools provider and consolidator in the space. Last year, Thermo Fisher acquired gene and cell therapy manufacturer Brammer Bio, and in March it announced its acquisition of Qiagen, which expands its diagnostics capabilities.

Liquid biopsy Another theme we are excited about is liquid biopsy. This theme is not being impacted either negatively or positively by COVID-19. One example is **Guardant Health, Inc. (GH)**, a leader in liquid biopsy for advanced cancer patients. The company is also developing products to monitor patients for cancer recurrence and blood-based screening products for early cancer detection. This week, Guardant presented some promising data on its blood-based colon cancer screening test. If successful, this product could be a game changer for colon cancer screening because most people would prefer a blood test over a stool based test or a colonoscopy.

Medical technology We believe the use of software-based data and analytics to speed drug development has massive growth potential. A good example of this is **Schrodinger, Inc. (SDGR),** which has a computational platform that can predict the binding affinity of a drug molecule with a high degree of accuracy. This platform enables scientists to discover novel molecules more rapidly at lower cost and with a higher likelihood of success. Schrodinger is using its computational platform to screen for and evaluate different protein targets for COVID-19. Another example is **Veeva Systems Inc. (VEEV)**, which provides cloud-based software that helps its clients bring drugs to market faster and more efficiently.

Have you added any new names to the portfolio recently?

Neal Kaufman: In the first quarter, we initiated positions in two global leading biopharmaceutical companies, Roche Holding AG and Sanofi, after their stock price pulled back significantly along with the overall market. We think both these companies have solid balance sheets and strong growth potential based on their pipelines. Schrodinger is another new holding. We bought shares when it went public in February. Schrodinger has a unique physics-based computational platform for drug discovery that has been developed over 30 years. The stock has quadrupled since its IPO. We think it's just getting started.

Josh Riegelhaupt: Another new holding is **Applied Therapeutics, Inc. (APLT).** Applied Therapeutics is a small biotechnology company developing treatments for an orphan disease that affects children at birth as well as other diseases associated with diabetes. Early data for the company's drug for the orphan disease showed promise and we think it will launch next year. We like management's approach, which we believe has to potential to drive faster and cheaper drug development. We also think that its drug for Diabetic Cardiomyopathy (a disorder of the heart in diabetic patients) has blockbuster potential.

What differentiates Baron Health Care Fund from its competitors?

Neal Kaufman: We apply the Baron investment philosophy to the Health Care sector, focusing on secular growth, competitive advantage, and great management teams. We conduct in-depth independent research, take a long-term perspective and strive to have low turnover. Baron's reputation gives us great access to management teams who like having us as investors because of our thoughtful long-term approach. We also have access to IPOs and interesting private companies that are close to going public, which allows us to monitor new trends. We think our portfolio is differentiated as well. With 40 to 50 stocks in the Fund, we have fewer stocks than the typical health care fund. Our holdings tend to have higher growth characteristics and a smaller market cap than the typical fund.

Sector Outlook

What is your current outlook for the Health Care sector?

Neal Kaufman: We think this pandemic will result in more investment in scientific research and pandemic preparedness. Even before the pandemic, we expected that we would be seeing advancements in cures and treatments over the next decade driven by major breakthroughs in gene therapy, and we think this pandemic will only accelerate these trends. NIH funding has been increasing. The political risks for health care have diminished. If the Democrats were to win the presidency and majorities in Congress, we would expect the ACA to be strengthened and Medicare and Medicaid to be expanded.

The FDA has implemented regulatory pathways that speed drug approvals and we've seen record numbers of new drug approvals over the past few years. Therapies are increasingly targeting genetic alterations or are using biomarkers, which result in higher odds of success and faster paths to approval, and ultimately require less investment to commercialize. Software that can provide predictive modeling and data analytics offered by companies like Schrodinger drive higher probabilities of success and faster drug development timelines. For all these reasons, we think that both the current environment and the long-term outlook for the sector is favorable.

Investors should consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The prospectus and summary prospectuses contain this and other information about the Funds. You may obtain them from the Funds' distributor, Baron Capital, Inc., by calling 1-800-99BARON or visiting www.BaronFunds.com. Please read them carefully before investing.

Baron Health Care Fund's annualized returns for the Institutional Shares as of March 31, 2020: 1-year, 6.84%; Since Inception (4/30/2018), 8.58%. Annual expense ratio for the Institutional Shares as of December 31, 2019 was 2.39%, but the net annual expense ratio was 0.85% (net of the Adviser's fee waivers). The **Russell 3000 Health Care Index**'s annualized returns as of March 31, 2020: 1-year, -2.11%; Since Fund Inception (4/30/2018), 5.86%.

The performance data quoted represents past performance. Past performance is no guarantee of future results. The investment return and principal value of an investment will fluctuate; an investor's shares, when redeemed, may be worth more or less than their original cost. The Adviser reimburses certain Baron Fund expenses pursuant to a contract expiring on August 29, 2030, unless renewed for another 11-year term and the Fund's transfer agency expenses may be reduced by expense offsets from an unaffiliated transfer agent, without which performance would have been lower. Current performance may be lower or higher than the performance data quoted. For performance information current to the most recent month end, visit www.BaronFunds.com or call 1-800-99BARON.

The Fund's 1-year historical performance was impacted by gains from IPOs and/or secondary offerings, and there is no guarantee that these results can be repeated or that the Fund's level of participation in IPOs and secondary offerings will be the same in the future.

Risks: In addition to general market conditions, the value of the Fund will be affected by investments in health care companies which are subject to a number of risks, including the adverse impact of legislative actions and government regulations. The Fund is non-diversified, which means it may have a greater percentage of its assets in a single issuer than a diversified fund. The Fund invests in small and medium sized companies whose securities may be thinly traded and more difficult to sell during market downturns.

The discussion of market trends is not intended as advice to any person regarding the advisability of investing in any particular security. The views expressed in this document reflect those of the respective writer. Some of our comments are based on management expectations and are considered "forward-looking statements." Actual future results, however, may prove to be different from our expectations. Our views are a reflection of our best judgment at the time and are subject to change at any time based on market and other conditions and Baron has no obligation to update them.

Portfolio holdings as a percentage of net assets as of March 31, 2020 for securities mentioned are as follows:

Abbott Laboratories – 5.9%; **Roche Holding AG** – 5.1%; **Sanofi** - 1.5%; **AstraZeneca PLC** – 5.9%; **DexCom, Inc.** – 1.9%; **Masimo Corporation** - 1.1%; **Intuitive Surgical, Inc.** – 3.0%; **West Pharmaceutical Services, Inc.** – 0.4%; **Bio-Techne Corporation** – 1.1%; **Thermo Fisher Scientific Inc.** – 3.7%; **Guardant Health, Inc.** – 1.3%; **Schrodinger, Inc.** – 3.1%; **Veeva Systems Inc.** - 1.1%; **Applied Therapeutics, Inc.** – 1.1%.

Top 10 holdings as of March 31, 2020

Holding	% Assets
UnitedHealth Group Incorporated	6.3
Abbott Laboratories	5.9
AstraZeneca PLC	5.9
Roche Holding AG	5.1

Vertex Pharmaceuticals Incorporated	4.8
Thermo Fisher Scientific Inc.	3.7
argenx SE	3.2
Schrodinger, Inc.	3.1
Humana Inc.	3.0
Edwards Lifesciences Corp.	3.0
Total	44.0

Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

Russell 3000® Health Care Index is an unmanaged index representative of companies involved in medical services or health care in the Russell 3000 Index, which is comprised of the 3,000 largest U.S. companies as determined by total market capitalization. Russell Investment Group is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell is a trademark of Russell Investment Group. The index performance is not fund performance; one cannot invest directly into an index.

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