Alex Umansky: Where do we go from here?

This is an edited version of a February 17, 2022, Q&A with Alex Umansky, Portfolio Manager of Baron Global Advantage Fund and Strategy, Baron Fifth Avenue Growth Fund, Baron Large Cap Growth Strategy, and Baron Durable Advantage Fund and Strategy. To access the recording, please dial 800-633-8284, passcode #22015468.

Executive Summary

- COVID has been a meaningful accelerant for digital transformation. Baron Global Advantage Fund and Baron Fifth Avenue Growth Fund were already heavily leveraged to this trend.
- Our estimates of intrinsic value for many companies have either not changed or are under review because we need more information. When we filter out the noise and focus on competitive advantage and the key drivers of economic value creation, negative news is transitory. The criteria that really matter are likely to last.
- We focus on the spread between the cost of capital and a company's return on capital. Because we invest in high-quality businesses with pricing power and proven ability to pass on the cost of inflation, the spreads between weighted cost of capital and terminal growth are not being affected nearly as much as the talking heads would have you believe.
- The depths of 2008 or 2009 looked bleak but also proved to be an incredible opportunity to allocate fresh capital. In late February and early March of 2020, it looked awful. Markets lost on average 35% over a seven-week period. Yet from there, even up to today, it was a good opportunity to allocate capital.

Fund Performance

Since inception through 12/31/21, Baron Global Advantage Fund has a cumulative return of 430%, significantly outperforming the MSCI AWCI Index and the MSCI AWCI Growth Index, whose cumulative returns are at 177% and 250%, respectively. As of 12/31/21, the Fund has a 5-star overall rating from Morningstar.

Since inception through 12/31/21, Baron Fifth Avenue Growth Fund has a cumulative return of 622%, just shy of the Russell 1000 Growth Index, but ahead of the S&P 500 Index, with cumulative returns of 743% and 515%, respectively. Alex began managing Baron Fifth Avenue Growth Fund on 11/1/2011, and performance after a two-month period of portfolio reconstruction reflects Alex's management.

Since inception through 12/31/21, Baron Durable Advantage Fund has a cumulative return of 108%, just ahead of the S&P 500 Index's cumulative return of 92%. As of 12/31/21, the Fund has a 4-star overall rating from Morningstar for its 3-year performance period.

For the period ended 12/31/2021, Baron Global Advantage Fund received a 5-Star Morningstar Rating™ for its 3-year, 5-year, and Overall risk-adjusted performance. The Morningstar Ratings™ were based on 306, 261, and 306 share classes for the 3-year, 5-year and Overall periods, respectively. The Morningstar Ratings™ are for the Institutional share class only; other classes may have different performance characteristics. The Morningstar Ratings are based on the Morningstar Risk-Adjusted Return measures.

For the period ended 12/31/2021, Baron Durable Advantage Fund received a 4-Star Overall Morningstar Rating™ and 4-Star 3-Year Rating. The Morningstar Ratings are based on the Morningstar Risk-Adjusted Return measures of 1116, and 1116 funds in the category, respectively. This Morningstar Rating is for the Retail share class only; other classes may have different performance characteristics.

Morningstar calculates the Morningstar World Large-Stock Growth and Large Growth Category average performance and rankings using its Fractional Weighting methodology. Morningstar rankings are based on total returns and do not include sales charges. Total returns do account for management, administrative, and 12b-1 fees and other costs automatically deducted from fund assets.

Q&A with Alex Umansky

Please provide a quick recap of performance in Q4 and 2021.

The performance of Baron Durable Advantage Fund once again diverged from the performance and fundamentals of the other two strategies. The Fund had the best performance in the Baron Funds line-up last year, up over 32%. The second half of Q4 was brutal for Baron Global Advantage Fund and Baron Fifth Avenue Growth Fund, producing significantly negative relative returns.

Baron Durable Advantage Fund is, in my view, as close to an all-weather stock portfolio that we have. This portfolio is designed to generate attractive returns over full market cycles with what we believe to be a low risk of permanent loss of capital. We think it is an excellent choice if your benchmark is the S&P 500 Index and you have no appetite to deal with the kind of volatility that we are seeing in growth stocks right now.

Baron Global Advantage Fund and Baron Fifth Avenue Growth Fund are run in the same way. Fifth Avenue is in a smaller theater because it is focused on U.S. large caps, while Global Advantage can invest in any size market cap anywhere in the world.

How do you characterize what happened in 2021?

Cyclicality happened. The markets are inherently cyclical. We've had an extended super cycle where growth significantly outperformed value. That ended in February of last year. Value has been outperforming growth since then across all market caps and pretty much across all geographies. We were matching value returns and even beating our benchmarks through the middle of November, then it just changed. It's not like there wasn't inflation before late November or that the Fed hadn't already been saying that rates were going to be raised in 2022. But in late November, those two factors became the only things that mattered.

Day-to-day stock prices are driven by headlines and the emotions they generate. In the long run, stock prices will reflect a business's true economic or intrinsic value. Here's a recent example: Look at the stock performances of **Amazon, Inc.** and **Alphabet, Inc.** [Google] over the last two years. Amazon was one of the biggest gainers in 2020 as the pandemic accelerated the shift to e-commerce. While its intrinsic value is probably compounding somewhere between 15% and 20% at this stage of its life cycle, its stock price was up a whopping 76% in 2020. Though its intrinsic value probably grew a little more than that 15% to 20% that year due to COVID, it most certainly did not increase by 76%, right? In 2021, Amazon's stock price rose just 2%. Its true economic value ostensibly increased more than 2% in 2021, but the fundamentals had to play catch-up to the stock price. Google was the complete opposite. Because of the pandemic, it was one of the biggest laggards in 2020. Lo and behold, in 2021, Google's stock was up almost 70%, significantly more than the increase in the economic value that Google had created over those previous 12 months.

That brings us to an important point. Your expected returns are always negatively correlated to current or recent returns. Investors tend to overweight or extrapolate short-term results, and so moves in stock prices tend to exaggerate business fundamentals, both up and down. So, when stock prices have been rising and continue to rise, your prospective of future returns are definitionally declining. When the market is in drawdown, your expected returns begin to rise. Now, I don't want to oversimplify or make it sound like this is an ordinary reversion to the mean. I think market participants, including us, either underestimated or did not fully grasp the profound impact COVID is having, and will continue to have, on the economy.

The Amazon and Google dynamics are easy to understand. We got that right and acted accordingly. **T**he obvious beneficiaries of work-from-home -- **Peloton Interactive Inc., ZoomInfo Technologies Inc., Netflix, Inc.,** and **Shopify, Inc.** -- were on one side, and the Energy sector, airlines, travel, and hospitality were on the other side. They were all relatively intuitive. And I think pretty much everyone took advantage of some and missed or avoided others.

What quickly became clear was that COVID was a meaningful accelerant for digital transformation, which is a major economic shift. Baron Global Advantage Fund and Baron Fifth Avenue Growth Fund were already heavily leveraged to this trend. Cloud computing and digitization of retail, advertising, payments, and health care were all disruptions we were invested in before COVID. Suddenly, companies we expected to grow 25% or 30% were growing 50 % or 60%. Companies we thought could grow 50% or 60% were growing 100% or more. The obvious questions were when will conditions normalize and what will this new normal actually look like? These were not easy questions. Nothing about COVID was normal or predictable or model-able.

We also need to account for government responses to COVID globally. Low rates or negative rates is one thing, but we had an unprecedented amount of stimulus that went directly to small businesses and consumers. The U.S. alone dispensed over $6 trillion in stimulus money to small businesses and people and then on its way to Amazon and Shopify and, in the process, altering people's behavior.

Toward the end of 2021, there was a sense that conditions would normalize. But no one knows what this "new normal" will look like. I will give you an example. Shopify stopped giving guidance when the pandemic began. It grew revenues 86% in 2020, up from 47% in 2019. The stock exploded. Yesterday, Shopify reported 2021 growth was down to 57% and said the only thing it knew for sure about 2022 is that it will decelerate further. Will it go back to the 47% of 2019 or lower to digest the bump of the last two years? We have no idea. I don't think the management knows either. The stock price peaked in mid-November around $1,800/share and is now $700/share, or down 60% in three months. What's changed in terms of company fundamentals? I would argue not all that much. I guess you also could argue that everything's changed, right? We remain in times of heightened uncertainty, and hidden or unknown information is always an impediment to good decision making. That goes for both investors and company management teams.

Can you comment on how record inflation and rising rates influence your approach, if at all?

Along with everything else, inflation is cyclical. Obviously, a lower cost of capital is a tailwind for businesses and a higher cost of capital is a headwind. But we focus more on the spread between the cost of capital and return on capital. If the spread is high enough, a higher cost of capital will not prevent or impede our companies' ability to create economic value. This is why we select businesses whose return on capital is rising. It allows them to offset the increasing cost of capital.

Our cost of capital assumptions are rising across the board, which is a headwind to intrinsic values. But as interest rates normalize back to historical averages, so will terminal growth assumptions. Because we invest in high-quality businesses with pricing power and proven ability to pass on the cost of inflation, the spreads between the cost of capital and terminal growth are not being affected nearly as much as the talking heads would have you believe. The calculations change, but they're not nearly as significant as people would think.

Has the performance over the last couple of months of companies you own affected their intrinsic values?

It varies. I would say companies have broadly fallen into two categories. The first includes companies like **Datadog, Inc., Cloudflare, Inc., NVIDIA Corp.,** and ZoomInfo, and even **Illumina, Inc., Endava plc, and EPAM Systems, Inc.** These businesses are basically on fire. The intrinsic values they are creating, are unequivocally rising. Every time we get updated results and data points, their economic values rise. These have been core holdings for a long time. Now, their stocks are all down 30% to 40% from their November highs.

The second category includes companies like **Wix.com Ltd.** or **10X Genomics, Inc.** or even a company like Shopify. In this category, COVID has distorted the numbers to such an extent that it is difficult for us to get conviction on the actual baseline. We can do sensitivity analysis and base case four to five years out and I think we will be pretty close, for but 2022 and even 2023, what's normal? So, our estimates of intrinsic values for these companies have either not changed or are under review because we need more information. There is some clear and obvious uncertainty. However, when we filter out the noise and focus just on competitive advantage and key drivers of economic value creation, the negative factors are transitory. The criteria that really matter will likely last.

Can you discuss why you have reduced the number of stocks in the Global Advantage and Fifth Avenue Growth portfolios?

We've always said that we do not guard against market volatility, but we do guard against over-diversification. Our preference is to run higher conviction, more concentrated portfolios.

In mid to late 2020, the valuations of many of our investments had become stretched. Investors were excited and we were the beneficiaries of significant inflows. Because we wouldn't chase many of these stocks, our response was to go wider and to increase the number of names by looking at specs or, in some cases, even at privates. The investing environment was favorable, and we needed to put a lot of money to work.

Now, with this rotation and a drawdown in some of our higher-conviction, higher-quality names, this trend will unwind. For Fifth Avenue, our normal preferred range is 30 to 40 names. I would not be surprised if we end up less than 30 when all is said and done. For Global, our normal range is 40 to 50 names. We peaked at around 67, but I expect we will be well inside of 50 and probably closer to 40 shortly.

What is your current thinking on China?

China is the second-largest economy in the world with a rising standard of living, and the largest – and still emerging -- middle class. While the growth potential is undeniably substantial, we will continue to be cautious. We did not leave China, nor are we ever going to leave China, but I don’t think we will be aggressive there for a while. It is hard to underwrite long-term investments when conditions are not consistent or necessarily aligned with long-term shareholder value creation. China is still a conundrum. It's just a cheaper conundrum. It bears watching, and we have to pay attention.

Rivian Automotive, Inc., which you owned as a private company, is now public. Can you talk about that?

We first invested about two years ago, at an $8 billion valuation pre-IPO. We re-upped at $25 billion six or seven months later. These were small investments. The primary motivation was to get a seat at the table and learn more about the company, management, and what they're trying to accomplish.

When Rivian filed its S-1 in September, we spent a couple of days with the company to do due diligence and decide whether it was time to allocate significant amounts of capital. We spent hours touring the factory – its paint shop, chassis construction, motors, electric battery production -- and learning about the software and battery management system. We test drove the cars and delivery vans. We met with close to two dozen top-level executives. There were lots of inputs and takes, uncertainties, questions around how many things needed to go right and how lumpy it was likely to be. Our simple and unavoidable conclusion was that this is the right company, with the right business model, employees, and management team, coming at the right time, to make it work.

We at Baron believe the future of transportation will be electric and autonomous. We have high conviction that Rivian will likely be one of the leading players in the space. But we also think the stock will volatile for a while, not unlike Tesla, because there are no current metrics for valuation.

How important is timing for successful long-term results?

You have to get the timing right at least some of the time. But I do not believe anyone can get it right all the time. A lot of short-term action is driven by algorithms and high frequency traders. The variables or the inputs that go into their decisions are different than the key drivers of value creation that we have to get right. Algorithms don't know how to judge uniqueness. They don't know how to estimate competitive advantage. They don't put duration of growth into their formulas. And I believe if we get those key drivers of economic value creation right, timing your entry points become less impactful in the long run.

What are your thoughts moving forward?

This is a difficult period, but there is a lot of money to be invested out there. And, as they say, it is always darkest before dawn.

The depths of 2008 or 2009 looked bleak, but that also proved to be an incredible opportunity to allocate fresh capital. At the onset of the pandemic, it looked awful. Markets lost on average 35% over a seven-week period. Yet from there, even up to today, it was a good opportunity.

High-quality businesses are down substantially from where they were a few months ago. But most of them will still be around five or 10 years from now, and almost certainly larger than they are today. Back in 2008/2009 Amazon went from $100 to $4. Microsoft went from $60 to $20. If you held on, you were rewarded handsomely.

I don't think this time will be different. I believe this time will prove to be a good buying opportunity.

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 Durable Advantage Fund's annualized returns for the Institutional Shares as of December 31, 2021: 1-year, 32.16%; 3-years, 30.93%; Since Inception (12/29/2017), 20.11%. Annual expense ratio for the Institutional Shares as of September 30, 2020, was 2.40%, but the net annual expense ratio was 0.30% net of the Adviser's fee waivers). The **S&P 500 Index's** annualized returns as of December 31, 2021: 1-year, 28.71; 3-years, 26.07; Since Fund Inception (12/29/2017), 17.65%.

Baron Fifth Avenue Growth Fund's annualized returns for the Institutional Shares as of December 31, 2021: 1-year, 11.22%; 5-years, 26.34%; 10-years, 19.64%; Since Inception (4/20/2004), 11.84%. Annual expense ratio for the Institutional Shares as of December 31, 2020, was 0.78%, but the net annual expense ratio was 0.75% (net of the Adviser's fee waivers). The **S&P 500 Index's** annualized returns as of December 31, 2021: 1-year, 28.71%; 5-years, 18.47%; 10-year, 16.55%; Since Fund Inception (4/20/2004), 10.83%.

Baron Global Advantage Fund's annualized returns for the Institutional Shares as of December 31, 2021: 1-year, 0.90%; 5-years, 30.62%; Since Inception (4/30/2012), 18.82%. Annual expense ratio for the Institutional Shares as of September 30, 2020, was 0.92%. but the net annual expense ratio was 0.90% (net of the Adviser's fee waivers). **MSCI ACWI Index** annualized returns as of December 31, 2021: 1-year, 18.54%; 5-years, 14.40%; Since Fund Inception (4/30/2012), 11.12%. **MSCI ACWI Growth Index** annualized returns as of December 31, 2021: 1-year, 17.10; 5-years, 19.92%; Since Fund Inception (4/30/2012), 13.82%.

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, 2032, 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.*

Risks:

Baron Fifth Avenue Growth Fund invests primarily in equity securities, which are subject to price fluctuations in the stock market. Even though the Fund is diversified, it may establish significant positions where the Adviser has the greatest conviction. This could increase volatility of the Fund's returns.

Baron Durable Advantage Fund invests primarily in equity securities, which are subject to price fluctuations in the stock market. In addition, because the Fund invests primarily in large-cap company securities, it may underperform other funds during periods when the Fund's securities are out of favor.

Baron Global Advantage Fund invests in growth stocks that can react differently to issuer, political, market and economic developments than the market as a whole. Non-U.S. investments may involve additional risks to those inherent in U.S. investments, including exchange-rate fluctuations, political or economic instability, the imposition of exchange controls, expropriation, limited disclosure and illiquid markets, resulting in greater share price volatility. Securities of small and medium-sized companies may be thinly traded and more difficult to sell.

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 total investments as of December 31, 2021, for securities mentioned are as follows: Amazon.com, Inc.. – 7.6% (Baron Fifth Avenue Growth Fund), 4.9% (Baron Global Advantage Fund; **Alphabet, Inc. -** 6.2% (Baron Durable Advantage Fund), 7.5% (Baron Fifth Avenue Growth Fund), 6.5% (Baron Global Advantage Fund); **ZoomInfo Technologies, Inc.** – 2.5% (Baron Fifth Avenue Growth Fund), 2.5% (Baron Global Advantage Fund); **Shopify, Inc. –** 4.1% (Baron Fifth Avenue Growth Fund), 4.0% (Baron Global Advantage Fund); **Datadog, Inc.** – 1.9%; (Baron Fifth Avenue Growth Fund), 1.5% (Baron Global Advantage Fund), **Cloudflare, Inc.**- 1.9% (Baron Global Advantage Fund); **NVIDIA Corp.**– 4.3% (Baron Fifth Avenue Growth Fund), 1.5% (Baron Global Advantage Fund); **Illumina, Inc.** – 2.1% (Baron Fifth Avenue Growth Fund), 1.9% (Baron Global Advantage Fund); **Endava plc** – 4.7% (Baron Global Advantage Fund); **EPAM Systems, Inc.** – 4.6% (Baron Fifth Avenue Growth Fund), 4.3% (Baron Global Advantage Fund); **Wix.com, Ltd.** – 1.3% (Baron Fifth Avenue Growth Fund), 1.6% (Baron Global Advantage Fund); **10X Genomics, Inc.** – 1.7% (Baron Fifth Avenue Growth Fund), 1.7% (Baron Global Advantage Fund); **Rivian Automotive, Inc.** – 7.0% (Baron Fifth Avenue Growth Fund), 7.3% (Baron Global Advantage Fund);.

Baron Durable Advantage Fund Top 10 holdings as of December 31, 2021

Holding	% Assets
Microsoft Corporation	8.6
Alphabet, Inc.	6.2
UnitedHealth Group Incorporated	4.9
Arch Capital Group, Ltd.	4.0
Danaher Corporation	4.0
Thermo Fisher Scientific Inc.	3.9
Accenture plc	3.9

Mastercard Incorporated	3.8
Meta Platforms Inc.	3.5
HIS Markit Ltd	3.5
Total	46.3

Baron Fifth Avenue Growth Fund Top 10 holdings as of December 31, 2021

Holding	% Assets
Amazon, Inc.	7.6
Alphabet, Inc.	7.5
Rivian Automotive, Inc	7.0
ServiceNow, Inc.	4.9
EPAM Systems, Inc.	4.6
NVIDIA Corporation	4.3
Shopify, Inc.	4.1
Intuitive Surgical, Inc.	4.0
Mastercard Incorporated	3.9
Adobe Inc.	3.7
Total	51.6

Baron Global Advantage Fund Top 10 holdings as of December 31, 2021

Holding	% Assets
Rivian Automotive, Inc.	7.3
Alphabet, Inc.	6.5
Amazon.com, Inc	4.9
Endava plc	4.7
EPAM Systems, Inc.	4.3
Shopify, Inc.	4.0
argenx SE	3.2
MercadoLibre, Inc.	2.8
ZoomInfo Technologies Inc.	2.5
Twilio Inc.	2.3
Total	42.5

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

Diversification cannot guarantee a profit or protect against loss.

The **Russell 2000® Growth Index** measures the performance of small-sized U.S. companies that are classified as growth. The **S&P 500 Index** measures the performance of 500 widely held large-cap U.S. companies. 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 indexes and the Funds include reinvestment of dividends, net of withholding taxes, which positively impact the performance results. The indexes are unmanaged. Index performance is not fund performance; one cannot invest directly into an index.

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The **Morningstar Rating™** for funds, or “star rating”, is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product’s monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The Morningstar Rating does not include any adjustment for sales loads. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10- year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods.

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