Alex Umansky: Where do we go from here?

This is an edited version of a May 11, 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 visit our website.

Executive Summary

- We have clearly entered a bear market for growth stocks.
- As long-term investors, we view bear markets as an opportunity to upgrade the quality of our portfolio.
- There is no algorithm or method that can consistently predict short-term market fluctuations. The only thing we can do is focus on our company-specific research and fundamentals. That's our skillset, and this is where we can add value over the long run.
- When Russia invaded Ukraine back in 2014, we decided that Russia was uninvestable and have not invested in Russia, Belarus, or Ukraine equities since that time.
- As a source of new ideas, we think India is far more interesting than China.
- The more outsized our gains, and the better our outperformance, the more we need to temper our expectations. On the other hand, the deeper the draw down, the more enthusiastic we should be about the opportunities ahead.

Q&A with Alex Umansky

Can you talk about how you apply the Baron growth philosophy in the context of current conditions?

We have clearly entered a bear market for growth stocks. During the mid-2020 peak, we noted the best investors or CEOs do not measure their success in percentage points or dollars. They measure it in lessons learned. When you're trying to build long-term value, you'll have wins and losses. Lessons learned become the currency when you operate without a finish line because they can be applied along the journey. There are times when things you know to be true, lessons you've learned firsthand, can hurt you in the short-term.

Can you give an example?

A couple come to mind. First, we have learned over the years that market corrections or bear markets should be used as an opportunity to upgrade portfolio quality. We all know the market is cyclical, and while everyone wants to own high-quality businesses, there are periods when investors get overexcited. They pile in and make certain stocks, sometimes entire categories of stocks, very expensive. We saw that in late 2020 and in 2021, when leaders in digital transformation or cloud computing were trading at very high multiples. Investors like us would try to find very good businesses at more attractive prices instead of allocating capital to the very best ones that were priced very highly. Our experience taught us when a market pullback or a

correction happened, the valuations of the leading companies would become more appealing. Then we could sell those good businesses to buy the best ones and upgrade the quality of the portfolio.

We deployed this concept successfully during the European debt crisis, when Russia invaded Ukraine in 2014, and during the selloff in 2020. We tried to do the same thing in the first quarter of 2022. We sold names like **RingCentral, Inc., Dynatrace Holdings LLC, Alibaba Group Holdings, Inc.,** and **Wix.com, Ltd.**, companies we believe to be solid, inexpensive, with generally good prospects. We reallocated that money into names like **Snowflake, Inc., Datadog, Inc., and CrowdStrike Holdings, Inc.,** companies we believe to be best-in-class.

It is not uncommon for lower-quality companies to go down first and go down harder and for the leaders to decline less in the earlier stages of a selloff. So, the companies we were buying were down 20% to 30%, while companies we were selling were down 50% to 60%. This would not be a problem if the selloff was just a correction and not a full-fledged bear market. But once the former turned into the latter, companies we bought went down much harder than the ones we sold that were already down substantially. What would have been a good-sized hole to begin with was dug deeper. In this case, an old lesson learned misfired.

Another example is perhaps less impactful but even more instructive. During the 2001-2002 Internet bubble crash, I came away with some lessons on how to better protect investor capital. During the crash of 2008-09, I put those lessons to use. Even with a limited toolset, where we couldn't short or go to cash, we could still sell puts and buy the volatility indexes to basically take out insurance on a chunk of the portfolio, offering significant downside protection at a time when the range of potential outcomes seemed particularly wide.

During this latest downturn, the problem was the markets were already down 30% to 35% and so the Volatility Index was through the roof, making that insurance very expensive. We did all the math to determine how much the market would need to go down for us to break even, and where we'd need to cover the puts. It took Ron [Baron] five minutes to basically tell me I was out of my mind. "That's not who we are or what we do. What in the world makes you think you can predict the direction of the market?" Being dismissed by Ron saved our shareholders from what could have been a significant permanent loss of capital. So, that was another lesson learned: Don't try to predict when the markets are being displaced.

Markets are complex, adaptive, and unpredictable. We're continuously learning, constantly adapting, and drawing lessons from the collective inputs. Our lessons are fine-tuned in real time. No algorithm or method can effectively predict the market with consistency. The only thing we can do is focus on our company-specific research and fundamentals. That's our skillset and where we can add value over the long run.

Have the companies in your portfolios retained, or strengthened, their intrinsic value?

Our quarterly letters, which are on the website, give a comprehensive overview using specific company examples and numbers. I'd say we can make a credible argument that more than three quarters of our investments are worth more now than six months ago. We can show mathematically, based on the reported financials, that their intrinsic values have unequivocally risen, while their stock prices have been pummeled.

During the quarter you reinvested in Tesla. What makes it attractive?

When I sold the stock three years ago, I did not believe Elon [Musk]. His target profitability goals seemed unachievable, like *Mission Impossible*. I was really hoping he would succeed, but I thought he was going to fail, especially with the balance sheet and the cash burn. What Tesla has accomplished is truly unprecedented. I don't think that's hyperbole. When you add **Space Exploration Technologies, Inc.** [SpaceX] you have to recognize there is something truly special here.

One of the harder things in this business is to admit when you were wrong, recognize a mistake, and then fix it if you get a chance. We have been fervent believers in electric autonomous shared mobility, and there was never any doubt that Tesla was in the driver's seat, no pun intended. But I did not envision it would achieve industry-leading margins, scale, and performance on every metric in this short amount of time. So, when we got the chance because of the market correction we reinvested.

There's concern about electric vehicle [EV] companies' ability to source nickel and lithium, which are essential for battery manufacturing. How does this impact your analysis of Tesla and Rivian?

The simple answer is it doesn't. It's not consequential to our long-term investment thesis. The world's going electric and autonomous. Tesla is the unquestioned leader in the space. I think even the naysayers, at this point, have nothing to point to other than the price. We believe **Rivian Automotive, Inc**. is a special company in the right time and place and will be one of the winners in this paradigm shift.

Rivian was the largest detractor in the quarter for Baron Global Advantage Fund. Why is it still one of your highest conviction positions?

When the stock goes from $8 billion to $25 billion to $180 billion, you have gains. Then when you decide you want to partner with the company for the long term because it is a leading player and a likely eventual winner in a multi-trillion-dollar market, you hang on.

We had a similar ride with **Illumina, Inc.**, which we bought when Global Advantage launched in early 2012. Illumina was the leader in next-generation DNA sequencing, with a market cap of $3 billion. At the time, it cost roughly $100,000 and several weeks to sequence human DNA. Our thesis was simple: the price will come down. The technology, at scale, could bring the price down to $10,000 or even $1,000. For the next three years, Illumina was either one of the largest contributors or one of the largest detractors. The stock was extremely volatile. We just stayed the course. Fast forward 10 years, and Illumina's market cap was $60 billion. In the last five months, it declined to $30 billion, but it's still a ten-bagger.

I think Rivian is going through the same thing. Our thesis for EV, where the largest cost is the battery, is not too dissimilar from DNA sequencing. As batteries scale, the price will come down. Valuations are higher because investors see the potential in EV. Tesla is Illumina, not Rivian. But this is a multi-trillion-dollar market, and there will be more than one winner.

What distinctions can you make between EPAM Systems and Endava's businesses, given that both have long runways and expanding addressable markets?

EPAM and Endava provide outsourced software development for businesses. Their business model is similar to **Globant, S.A.** and **Accenture plc**. **EPAM Systems, Inc.** has a market cap of $17 to $18 billion. **Endava plc** is $5 billion and Globant is $7 billion. The biggest differences are where these companies source their talent and have their delivery hubs. EPAM, which we think is the highest quality of the three and the standard, had 60% of its talent in Russia, Ukraine, and Belarus. Obviously, it's been disrupted, and its stock is down 53%. Endava, whom we spoke to numerous times, has told us that, if anything, this is an opportunity. Its stock is down 42%. Globant, which is mostly in Latin America, is down 45%. This is indiscriminate selling. While EPAM's stock should have declined because of the disruption, for Endava and Globant, that's not the case. Their estimates have increased, and their stocks are down by a similar amount.

What is the opportunity size? How big can they be, and why do we own all of them?

Accenture, which is pretty much doing the same thing, has a $182 billion market cap. It's growing a bit slower and trading at a different multiple because it's a more mature company, and a more meaningful part of its growth is from acquisitions. EPAM's organic growth was 40% while acquisitions were another 10%. Accenture's growth is half that rate but is still growing attractively given its size. We see at least a 10X opportunity for each of the three, given the massive supply/demand imbalance. This was our thesis eight to 10 years ago, and we think that thesis is firmly intact.

Why own all three? Probably the best answer is **Visa, Inc.** and **MasterCard Incorporated.** When Visa went public in 2008, at the time it was the largest IPO the markets had seen. We bought a lot and even more after the IPO. Then the financial crisis hit, and Visa lost 70% to 80% of its value. Everyone was asking, "Why do you own Visa when you already own so much MasterCard?" MasterCard was down the same amount. "Don't they both do the same thing, and isn't it the same opportunity? Why not just buy one?" The thesis was

simple. We saw a structural change from cash and checks to plastic, and these were the two leading companies.

It's the same argument here. We got to know EPAM very well. We think the CEO is an incredible businessman who understands the big picture. After we invested in EPAM, we met with Globant, and pattern recognition kicked in. It was doing what EPAM was doing, but in Latin America. It's rinse and repeat, and it made sense. Endava was the last one we met, and we thought it was the most interesting of all. So now we own all three.

Can you comment on your exposure to Russia and Ukraine? What actions have you taken as a result?

We used to invest in Russia, but when it invaded Ukraine for the first time in 2014, we decided that Russia was uninvestable. We had about 4% of the portfolio in Russia, sold all of it and have not ventured back in. We've never invested in Ukraine or Belarus. So, we did not have direct exposure.

Russia is the ninth largest country in the world, and the 11th largest by GDP. Obviously, it's one of the world's key energy producers. When Russia invaded Ukraine in February, we weren't surprised by what happened. With a top-10 country, everyone has some exposure. Almost all our companies have told us 1.5% or 2% of sales were impacted and are assuming it's permanently gone.

EPAM is a specific case. The most amazing thing was its first quarter results. Its organic revenue growth was over 40%, when 60% of its people were disrupted for two-thirds of the period. We were actually not surprised because we were talking to its customers and knew no one was canceling and people in Ukraine continued to work. We knew it was able to shift a lot of projects to other geographies. Amazingly, it added 2,300 new employees in the first quarter. So, we had much more confidence in EPAM in the short term than the market did. We think EPAM is fine for the next 6 to 12 months. Our long-term view is different. Its two largest geographies are Russia and Ukraine. The war is a material disruption. It is difficult to replace 60% of your workforce or to navigate the conflict among employees at the company. The range of potential outcomes is much wider. So EPAM, which was a top five position, is now significantly lower.

Any comments on China at this time?

Nothing's changed from my perspective. I think the COVID lockdowns bought us time, meaning there is no reason to rush into China. The country has a lot of ammunition to stimulate its economy, unlike the U.S. or Western Europe. It can lower rates while we're raising rates. China will likely look structurally more attractive, but our assumption is that Xi Jinping is intending to stay in power for life. That makes for a highly risky capital allocation proposition, in our view.

When I joined Baron 10 years ago, we viewed China as a great opportunity for the next 10 to 15 years, and India as a better one for the next 20 to 25 years after that. So, while we're looking at China, paying attention, and meeting with companies, I do not have the conviction to allocate more capital to China. We have three small investments in China which we think are dramatically undervalued. But as a source of new ideas or where we're looking to add, we think India is far more interesting.

You often refer to Forrest Gump when the climate becomes uncertain. Do you have any lessons to share from that investment sage?

"Life [is] like a box of chocolates. You never know what you're gonna get." This is an incredibly challenging environment. It is a little like *The Matrix*, where we've trained ourselves to stare at our screens and get fixated on the numbers. It is amazing how much these numbers affect our ability to remain calm and make objective, rational decisions.

It's impossible to predict the bottom. If history teaches us anything, it's that we don't know really know what the "right" multiples are either. But that's not part of our edge. I do know prospective returns are negatively correlated to recent and current results. So, the more outsized our gains, and the better our outperformance, the more we need to temper our expectations. On the other hand, the deeper the drawdown, the more excited we should get about the opportunities ahead.

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 March 31, 2022: 1-year, 15.07%; 3-years, 20.57%; Since Inception (12/29/2017), 15.81%. Annual expense ratio for the Institutional Shares as of September 30, 2021, was 1.48%, but the net annual expense ratio was 0.70% net of the Adviser's fee waivers). The **S&P 500 Index's** annualized returns as of March 31, 2022: 1-year, 15.65%; 3-years, 18.92%; Since Fund Inception (12/29/2017), 15.25%.

Baron Fifth Avenue Growth Fund's annualized returns for the Institutional Shares as of March 31, 2022: 1-year, -10.75%; 5-years, 17.15%; 10-years, 14.48%; Since Inception (4/30/2004), 10.21%. Annual expense ratio for the Institutional Shares as of September 30, 2021, was 0.75%. The **S&P 500 Index's** annualized returns as of March 31, 2022: 1-year, 15.65%; 5-years, 15.99%; 10-year, 14.64%; Since Fund Inception (4/30/2004), 10.38%.

Baron Global Advantage Fund's annualized returns for the Institutional Shares as of March 31, 2022: 1-year, -20.62%; 5-years, 20.20%; Since Inception (4/30/2012), 15.26%. Annual expense ratio for the Institutional Shares as of December 31, 2021, was 0.90%. The **MSCI ACWI Index's** annualized returns as of March 31, 2022: 1-year, 7.28%; 5-years, 11.64%; Since Fund Inception (4/30/2012), 10.21%. The **MSCI ACWI Growth Index's** annualized returns as of March 31, 2022: 1-year, 5.42%; 5-years, 15.47%; Since Fund Inception (4/30/2012), 12.29%.

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 March 31, 2022, for securities mentioned are as follows: Alphabet, Inc. – 8.6% (Baron Durable Advantage Fund), 8.0% (Baron Fifth Avenue Growth Fund), 5.3% (Baron Global Advantage Fund); **Space Exploration Technologies, Inc.** – 0.5% (Baron Fifth Avenue Growth Fund), 1.1% (Baron Global Advantage Fund); **Snowflake, Inc. –** 4.1% (Baron Fifth Avenue Growth Fund), 3.0% (Baron Global Advantage Fund); **Datadog, Inc.** – 3.0% (Baron Fifth Avenue Growth Fund); 2.4% (Baron Global Advantage Fund), **CrowdStrike, Inc.**- 4.5% (Baron Fifth Avenue Growth Fund); 3.8% (Baron Global Advantage Fund); **Tesla, Inc.**– 4.0% (Baron Fifth Avenue Growth Fund), 1.6% (Baron Global Advantage Fund); **Illumina, Inc.** – 2.5% (Baron Fifth Avenue Growth Fund), 2.1% (Baron Global Advantage Fund); **Endava plc** – 2.0% (Baron Fifth Avenue Growth Fund); 5.6% (Baron Global Advantage Fund); **EPAM Systems, Inc.** – 2.5% (Baron Fifth Avenue Growth Fund), 2.5% (Baron Global Advantage Fund); **Wix.com, Ltd.** – 1.4% (Baron Global Advantage Fund); **Accenture plc** – 4.5% (Baron Durable Advantage Fund); **Rivian Automotive, Inc.** – 4.5% (Baron Fifth Avenue Growth Fund), 4.6% (Baron Global Advantage Fund); **Visa, Inc.** – 3.8% (Baron Durable Advantage Fund); **Mastercard Incorporated** – 5.3% (Baron Fifth Avenue Growth Fund), 4.7% (Baron Durable Advantage Fund); **Globant S.A.** – 1.3% (Baron Global Advantage Fund). As of March 31, 2022, the Funds did not hold shares of RingCentral, Inc., Dynatrace Holdings LLC, and Alibaba Group Holdings, Inc.

Baron Durable Advantage Fund Top 10 holdings as of March 31, 2022

Holding	% Assets
Microsoft Corporation	9.3
Alphabet, Inc.	8.6
Arch Capital Group, Ltd.	5.2
S&P Global Inc.	5.1
UnitedHealth Group Incorporated	4.9
Mastercard Incorporated	4.7
Accenture plc	4.5
Thermo Fisher Scientific Inc.	4.0
Danaher Corporation	3.9
Visa, Inc.	3.8
Total	54.0

Baron Fifth Avenue Growth Fund Top 10 holdings as of March 31, 2022

Holding	% Assets
Amazon, Inc.	9.2
Alphabet, Inc.	8.0
NVIDIA Corporation	5.9
ServiceNow, Inc.	5.5
Mastercard Incorporated	5.3
CrowdStrike, Inc.	4.5
Rivian Automotive, Inc.	4.5
Snowflake, Inc.	4.1
Shopify, Inc.	4.0
Tesla, Inc.	4.0
Total	55.0

Baron Global Advantage Fund Top 10 holdings as of March 31, 2022

Holding	% Assets
Amazon.com, Inc	6.0
Endava plc	5.6
Alphabet, Inc.	5.3
Rivian Automotive, Inc.	4.6
CrowdStrike, Inc.	3.8
MercadoLibre, Inc.	3.8
ZoomInfo Technologies Inc.	3.6
argenx SE	3.6
Bajaj Finance Limited	3.1
Snowflake, Inc.	3.0
Total	42.4

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 **S&P 500 Index** measures the performance of 500 widely held large-cap U.S. companies. The **MSCI ACWI Growth Index** captures larges and mid cap securities exhibiting overall growth style characteristics across 23 Developed Markets countries and 26 Emerging Markets countries. MSCI is the source and owner of the trademarks, service markets, and copyrights related to the MSCI Indexes. The indexes and the Fund include reinvestment of dividends, net of foreign 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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