Andrew Peck: A Mid-Cap Growth Strategy That Can Withstand Headwinds

This is an edited version of a February 23, 2022, Q&A with Andrew Peck, Baron Capital co-Chief Investment Officer and Portfolio Manager of Baron Asset Fund, Baron Mid Cap Growth Strategy, and Baron All Cap Growth Strategy. To access the full recording, please dial 800-772-0358, passcode #22015477.

Executive Summary

- Baron Asset Fund outperformed during the fourth quarter and 2021. Holdings in Health Care, Financials, and Communication Services contributed to a gain of more than 500 basis points in the quarter, despite an increasingly challenging environment for growth stocks, particularly mid-cap growth.
- In recent months, growth has fallen out of favor relative to value investing, and mid-cap growth has been out of favor relative to larger-cap growth.
- We are using this dislocation as an opportunity to look at companies whose valuations suffered due to short-term issues that, in our view, have been blown out of proportion.
- We added StubHub Holdings, Inc. and Rivian Automotive, Inc. to the portfolio. We sold Zillow Group, Inc. after a specific management decision undermined our confidence.
- We have not repositioned the portfolio in response to macro events such as rising interest rates or inflation expectations. We trust in the resilience of our investment process and that the market will again appreciate the value of well-managed, competitively advantaged growth companies.

Baron Asset Fund

Could you recap Fund performance for the fourth quarter of 2021 and the full year?

The Fund closed the year on a high note, gaining 504 basis points in the fourth quarter. The Russell Midcap Growth Index rose 285 basis points during the quarter. The Fund ended the year up 14.1%, compared with a 12.7% gain for the index.

What were the strongest contributors and notable detractors?

Positive performance during the quarter reflected strength across three primary sectors -- Health Care, Financials, and Communication Services.

In Health Care we had strong performance by long-time holdings **Mettler-Toledo International, Inc., West Pharmaceutical Services, Inc., Bio-Techne Corporation,** and **IDEXX Laboratories, Inc.** All four reported robust third quarter earnings, and the stocks reacted favorably as a result.

Strength in the Financials sector was led primarily by **FactSet Research Systems, Inc.**, which also reported solid earnings during the quarter and got a boost from its acquisition of CUSIP Corporation. Longtime holding **The Charles Schwab Corporation** performed well as a result of robust earnings results and the increase in interest rates.

Lastly, within the Communication Services sector, a more recent investment, **ZoomInfo Technologies, Inc.** performed well. Again, this was the result of impressive earnings as well as the acquisition of a company called Chorus which was favorably viewed by the market.

Sectors and sub-industries that detracted from relative and absolute performance included Real Estate, in which **Zillow Group, Inc.**, the well-known consumer-facing website for home purchases, corrected meaningfully. Lack of exposure to the semiconductor sub-industry, which performed particularly well, hurt performance. Software names **Guidewire Software, Inc., Wix.com Ltd.,** and **RingCentral, Inc**. also detracted from performance as the Information Technology sector lagged the overall market. Within the industrial sector, long-time holding **CoStar Group**, **Inc.** detracted from performance.

From a factor-based perspective, positive performance was a result of being underweight the volatility and beta factors. On the negative side, the Fund's underweight in the liquidity factor was a headwind to relative results.

How do you see the current environment?

I would say broadly that this has been a difficult time for all equity investors, and particularly for growth-oriented investors. I just read a statistic that, during the month of January, the dispersion between the returns of growth equities and value equities was the greatest in more than 20 years. So, growth is very much out of favor relative to so-called value investing. In addition, mid-cap growth equities have been meaningfully out of favor relative to larger-cap growth equities. That being said, we do not make stock-based decisions based upon our view of the macroeconomic environment. We have not made meaningful changes in the portfolio as a reaction to the recent rise in interest rates, the rise in inflation expectations, etc.

We believe that business conditions are stable or, in many cases, improving for many of the investments in our portfolio. We think that the valuations at which they're now selling present particularly compelling opportunities for investors with a medium- to long-term time horizon. So, we're using the current dislocation as an opportunity to investigate beaten-up growth stocks, particularly those in which short-term issues, in our view, have been blown out of proportion.

Have you added new companies?

The Fund's two largest purchases were, first, a private but well-known company called **StubHub Holdings, Inc**. StubHub is the largest online marketplace for live event tickets. EBay purchased StubHub as a private company in 2007. By many accounts, eBay mismanaged StubHub during its roughly 10 years of ownership and eventually sold it to a company called Viagogo. We are excited by this new business combination because we believe the management team at Viagogo, led by the co-founder of the original StubHub, has a meaningful opportunity to apply business practices they have successfully used in international markets. We also see a large opportunity to reduce costs to operate more efficiently and to leverage StubHub's well-known consumer brand. The live event ticketing market is attractive, with meaningful pent-up consumer demand.

Our other large purchase in the quarter was **Rivian Automotive, Inc**. Rivian has been a well-known, well-followed private company for many years, one in which several other Baron Funds had already invested. Baron Asset Fund participated in its IPO during the fourth quarter. We have acquired valuable experience and insight in the electric vehicle (EV) market through our long-time ownership in **Tesla, Inc.** We believe that there is room for more than one winner in the EV space, and we think Rivian will be one of them.

In light of your StubHub purchase, may additional private companies follow?

The short answer is that there is an exceptionally high hurdle in my mind for the Fund to invest in private securities. The company must be meaningfully cash flow positive, and StubHub certainly meets that criterion. In addition, the company must have a very well-defined pathway toward becoming a public company at some point soon. That is also the case with StubHub. It filed a confidential S-1 statement last month. So, there is, I think, good reason to believe that StubHub will become a public entity sometime soon. Clearly, the recent volatility in the market could delay that process, but I don't expect a meaningful delay.

I would not expect private investments to ever be a meaningful percentage of the portfolio. I would never expect them to be more than a couple of percentile points. And they would all have to meet the exceptionally high hurdles that I and the team have laid out for private investments.

Zillow was recently eliminated. What prompted that decision?

This is a company that our firm has invested in since the company's IPO seven or eight years ago. It was led by Rich Barton, an executive with whom we've been familiar since he was CEO of Expedia. We had a long and successful investment in and partnership with **Zillow Group, Inc.** until several months ago when the company revealed that a recent business initiative had failed. Its plan was to transition its business model from a website that people visited for information related to purchasing or selling a home into iBuying. This is a model in which companies purchase homes with the intention of quickly selling those homes for a profit. Zillow intended to utilize its proprietary data as an edge to enter this relatively new market.

We were encouraged by Zillow’s initial business plan and thought they had some attractive attributes that would allow it to become a leader in the space. We were disappointed to see the venture turn during the fourth quarter, when Zillow announced a very meaningful write-down for the iBuying segment due to some poorly informed purchasing decisions and that it would shutter the segment. We felt that we no longer had sufficient confidence or visibility into the business model going forward and decided to exit that position.

I will say that we earned a reasonable return on our investment in Zillow over the time that we owned it, but the stock had corrected meaningfully from its all-time high. That was partly a result of broader business conditions in the housing market but also a result of the company's incursion into the iBuying space.

Closing thoughts?

This is a volatile and difficult market for growth investors. However, we remain confident in the tried and tested investment process we have followed for the last 30 or so years in managing this Fund. Even though macroeconomic issues are causing uncertainty and volatility, the business conditions for most of our investments are largely unchanged. We are confident that the market will again come to appreciate the value of fast-growing, well-managed, competitively advantaged companies.

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 Asset Fund's annualized returns for the Institutional Shares as of December 31, 2021: 1-year, 14.22%; 5-years, 21.62%; 10-years, 17.51%; Since Inception (6/12/1987), 12.52%. Annual expense ratio for the Institutional Shares as of September 30, 2021 was 1.03%.

Russell Midcap® Growth Index annualized returns as of December 31, 2021: 1-year, 12.73%; 5-year, 19.83%; 10-year, 16.63%; Since Fund Inception (6/12/1987), 11.08%.

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 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.

Performance for the Institutional Shares prior to 5/29/2009 is based on the performance of the Retail Shares, which have a distribution fee. The Institutional Shares do not have a distribution fee. If the annual returns for the Institutional Shares prior to 5/29/2009 did not reflect this fee, the returns would be higher.

Risks: Securities issued by medium sized companies may be thinly traded and may be more difficult to sell during market downturns. 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.

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 December 31, 2021, for securities mentioned are as follows: West Pharmaceutical Services, Inc. (3.0%); **Bio-Techne Corporation** (3.3%); **ZoomInfo Technologies, Inc**. (1.8%); **Mettler-Toledo International, Inc.** (5.2%); **The Charles Schwab Corporation** (2.4%); **Guidewire Software, Inc.** (2.5%); **RingCentral, Inc.** (0. 7%); **StubHub Holdings, Inc.** (0.7%); **WIx.com, Ltd.** (1.0%); **IDEXX Laboratories, Inc.** (7.0%); **FactSet Research Systems, Inc.** (2.8%); **Rivian Automotive, Inc.** (0.7%).

As of December 31, 2021, Baron Asset Fund did not hold **Zillow Group, Inc.**

Top 10 holdings as of December 31, 2021

Holding	% Assets
Gartner, Inc.	7.8
IDEXX Laboratories, Inc.	7.0
Mettler-Toledo International, Inc.	5.2
ANSYS, Inc.	3.6
Verisk Analytics, Inc.	3.5
Bio-Techne Corporation	3.3
Vail Resorts, Inc.	3.1

West Pharmaceutical Services, Inc.	3.0
FactSet Research Systems, Inc.	2.8
TransUnion	2.7
Total	**42.0**

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

The **Russell Midcap® Growth Index** measures the performance of medium-sized U.S. companies that are classified as growth. 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 and the Fund include reinvestment of dividends, net of withholding taxes, which positively impact the performance results. The index is unmanaged. Index performance is not fund performance. Investors cannot invest directly in an index.

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