Ron Baron, Neal Rosenberg, & Michael Baron: Staying the course with a long-term view

This is an edited version of a February 22, 2022, Q&A with Ron Baron, Neal Rosenberg, and Michael Baron. Ron is CEO of Baron Capital and portfolio manager of Baron Growth Fund and Baron WealthBuilder Fund, as well as Baron Partners Fund and Baron Focused Growth Fund, which he discusses in a separate Q&A. Neal Rosenberg is portfolio manager of Baron Growth Fund and Michael Baron is portfolio manager of Baron WealthBuilder Fund.

To access the full recording, please dial 800-633-8284, passcode #22015471.

Executive Summary

- The market has been wrestling with the outlook for inflation and interest rates. This has triggered a steep sell-off in high-quality stocks with long-duration earnings growth.
- In our view, trying to invest based on short-term macro variables is unproductive. The data is usually contradictory, transitory, and may already be captured in stock prices.
- We identify unique businesses with significant barriers to entry and compelling growth prospects. Our focus on fundamentals has resulted in favorable stock selection.
- In an inflationary environment, secular growth stocks with pricing power can offer investors real protection and compelling benefits.
- We believe our portfolios' robust long-term growth prospects and attractive valuations position us for outperformance over time.

Opening Comments from Ron Baron

Ron Baron: Everyone is talking about inflation, oil prices, interest rates, Russia. All we think about is focusing on the businesses in which we're investing for the long term, the people who run these businesses, their competitive advantages, and their opportunities.

Most people buy and sell stocks based on their predictions around the market's direction. We don't. The only thing we predict is inflation. Inflation has averaged 4% to 5% per year for my lifetime. Whether it's for a house, a car, a steak, tuition, anything you want to name, it's 4% to 5% a year. That means that the price of everything you want to buy doubles roughly every 14 or 15 years. That means that the value of your dollar falls in half every 14 or 15 years. And that's been that way for 50 or 60 years.

What we do is we invest in growth companies. The stock market grows - the economy grows 7% to 8% a year, the stock market something more than that, when you add in inflation maybe as much as 10% a year. And all that we try to do is invest in companies that we think can grow for the long term at over 15% a year.

We're taking advantage of the decline that's taking place so far this year and we're purchasing or adding to stocks that have been hardest hit. And we have been also purchasing companies where we think the price is attractive.

Baron Growth Fund

Please recap Fund performance in the fourth quarter of 2021 and the full year.

Neal Rosenberg: Baron Growth Fund gained 6.6% in the quarter, better than the Russell 2000 Growth Index, which was more or less flat. For the full year, the Fund gained 20.2%, well ahead of our benchmark, which gained just under 3%. As of 12/31/21, the Fund has a 4-star overall rating from Morningstar, as well as a 4-star rating for the 3-, 5-, and 10-year periods.

For the period ended 12/31/2021, Baron Growth Fund received a 4-Star Overall Morningstar Rating™, 4-Star 3-Year Rating, 4-Star 5-Year Rating, and 4-Star 10-Year Rating. The Morningstar Ratings are based on the Morningstar Risk-Adjusted Return measures of 538, 538, 491, and 380 funds in the category, respectively. This Morningstar Rating is for the Institutional share class only; other classes may have different performance characteristics.

Morningstar calculates the Morningstar Mid-Cap 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.

There was plenty of macro noise last quarter, as there always is, but we think that trying to invest based on any of those variables is unproductive. The data is usually contradictory, transitory, and may already be captured in stock prices. Instead, we identify and research unique businesses with significant barriers to entry and compelling growth prospects. We try to invest at attractive prices and hold them for the long term. This focus on fundamentals continues to generate favorable stock selection. Last year our results included 977 basis points of favorable stock selection. That's our fifth consecutive year with at least 400 basis points of favorable stock selection and an average annual contribution of around 750 basis points.

What type of companies do you favor in this environment?

Neal Rosenberg: We always focus on businesses with sustainable competitive advantages, run by management teams that reinvest in their companies. Constant reinvestment helps to expand addressable markets and raise barriers to entry, which, in turn, protects businesses from competition and allows them to raise prices.

On the cost side, we mainly invest in companies that incur high initial fixed costs to build their assets but then have high incremental margins on each new product sold. To accomplish this, these companies tend to sell products that use digital inputs, are asset light, employ high levels of automation, and have almost no exposure to commodity prices.

We've seen our businesses exercise their pricing power much more aggressively in recent months. Let me give you a couple of examples. **CoStar Group, Inc.** indicated that the new rate card for its apartment.com marketing network included 7% price increases for this year. Prices for some products increased by up to 20%. The company also resumed annual price increases in its core suite business after a multiyear hiatus. **Arch Capital Group, Ltd.** stands to benefit from global property cap pricing that rose by about 10% during its most recent renewal season. **Guidewire Software, Inc.** will benefit from the same rising premium rates since its customers pay an annual fee that's tied to the amount of premiums written by insurers. Composite decking manufacturer **Trex Company, Inc.** implemented four separate price increases last year. We think that aggregates to around a 15% uplift, which will benefit financial results this year.

So, while we're clearly cognizant of rising prices, we think our businesses are well-positioned to benefit from this dynamic. In an inflationary world, secular growth stocks with pricing power can offer real protection and compelling benefits.

Have you made any notable purchase or sales?

Neal Rosenberg: On the purchase side, we funded a previous commitment in **Mirion Technologies US Inc.**

Mirion is a leader in ionizing radiation detection and measurement. They serve the medical, laboratory and nuclear power industries. We also participated in the IPO of **Sweetgreen, Inc.** Sweetgreen is one of the fastest growing restaurant chains in the U.S. It sits at the intersection of powerful trends, including health and wellness, plant-based food consumption, digital interaction, and purpose-driven brands. Finally, we made a modest investment in vision care pioneer **Warby Parker Inc.** after its direct listing. As always, we kept these new positions small. In total, these three ideas were less than 1% of assets as of the end of the quarter.

On the sell side, we exited small positions in **SmartRent, Inc.** and **Adaptive Biotechnologies Corporation.** We also made modest reductions to some larger, highly appreciated positions. We allocated that capital to investments that we believe offer more attractive risk-adjusted returns, including the new positions I just mentioned.

Can you tell us what attracted you to Mirion?

Neal Rosenberg: Mirion consists of a portfolio of niche mission-critical products that detect and measure ionizing radiation. Products include dosimeters that monitor radiation levels of medical professionals, quality assurance equipment and software for nuclear medicine treatments, and instruments that are used in nuclear power plants.

The company is already the largest player in over 80% of its end-markets, and on aggregate is around 3.5 times larger than its nearest competitor. We estimate that Mirion's end-market should grow around 5% to 6% annually, driven by favorable secular trends and a consistent replacement cycle. Mirion should grow in line to ahead of its end-markets on an organic basis as it leverages that scale advantage to take some market share. Organic growth should be complemented by Mirion's acquisition strategy, driving total growth toward the double-digit range. In addition, we think the company has an opportunity to expand margins over time through a favorable mix shift, high utilization, and M&A synergies.

Finally, we think that Mirion has a very accomplished senior management team. The CEO has been with the company since 2005 and grown revenues from about $120 million to almost $700 million currently. Mirion's new chairman, Larry Kingsley, has a strong history of shareholder value creation. He's the former CEO of industrial leaders Pall and IDEX. We think Larry's expertise will be well-utilized as Mirion embarks on its next stage of growth.

You often talk about disruptive growth. Can you give some examples?

Neal Rosenberg: These are companies with novel products or services that are creating or disrupting vast addressable markets. They tend to be in a high-growth, high-investment phase of their life cycle. They're scaling off a relatively smaller base and aggressively reinvesting in pursuit of durable competitive advantages. While they're earlier in their maturity curves, they're targeting the same financial and strategic attributes that we value in all our investments: favorable secular trends, current revenue streams, and sustainable barriers to entry.

Let me give you a few examples. Companies like **ANSYS Inc., Altair Engineering, Inc.,** and V**elo3D, Inc.** are disrupting the traditional product development and manufacturing cycle. ANSYS and Altair are pioneers in simulation software. They help engineers test product layouts more quickly to identify optimal designs. Velo 3D is disrupting the manufacturing end of the process by inventing and productizing high-end manufacturing techniques. Software companies like **Guidewire Software, Inc.** and **Pegasystems, Inc.** are leveraging the power of cloud computing to disrupt manual processes in the insurance and financial services markets. Software as a service allows all companies to benefit from iterative software improvements, declining hardware costs, and labor outsourcing, in exchange for fixed annual fee. **Iridium Communications, Inc.** is disrupting satellite-based communications with its Iridium Next constellation. Iridium can leverage its fixed cost and unique technology to enable cheap near-universal connectivity, even in the most remote corners of the world. Finally, biotech companies like **Denali Therapeutics, Inc.** and **Schrodinger, Inc.** are pushing the boundaries of drug development by pursuing novel diagnostics and therapeutics in areas including neurodegenerative diseases and blood cancers.

While disruptive growth businesses offer exciting growth opportunities, they also carry relatively higher risk since they're younger, pursuing novel markets, and are investing aggressively. We try to actively balance risk and return across the portfolio to generate superior returns over time with less risk. To accomplish this, we allocate a smaller portion of the portfolio to disruptive growth, and we also own relatively smaller positions in individual disruptive growth stocks. Around 12% of our portfolio is in disruptive growth, versus 25% to 30% in each of the other buckets we invest in: Financials, Core Growth, and Real/Irreplaceable Assets. The average disruptive growth position size is around 1% as of fourth quarter, which is roughly half of the average position size across the other three cohorts.

What is your outlook for the rest of the year?

Neal Rosenberg: The market has been wrestling with the outlook for inflation and interest rates. This has resulted in a steep sell-off in high-quality stocks with long-duration earnings growth, particularly in the IT sector. We have always viewed inflation as a persistent and enduring feature of the economy, regardless of when or how it shows up in government metrics. As a result, we've always focused on companies that pose sustainable competitive advantages and are run by management teams that are reinvesting in their businesses.

Most importantly, we think that end-market conditions are stable to improving for most of our investments, most notably for those that did not benefit from a COVID-driven tailwind last year. We think the long-term earnings power of our portfolio is unchanged despite recent market volatility. As a result, we think this is a compelling time for investors to add to their holdings. We think our portfolio's robust long-term growth prospects and more attractive valuation position us for outperformance over time.

Baron WealthBuilder Fund

Please recap Fund performance in the fourth quarter 2021 and the full year.

Michael Baron: The Fund returned 6.09% for the fourth quarter of 2021 and 16.70% for the full year – in an environment where we saw a sharp shift in investor sentiment. Because of that shift, the S&P 500 did better on an absolute basis in both the quarter and the full year. The lingering effects of the pandemic, inflation, supply chain issues, labor shortages, interest rates -- these are all weighing on short-term values for growth. We don't think it's going to persist. We're staying the course.

We created Baron WealthBuilder Fund four years ago, to deliver broad exposure to our approach to growth equity investing, across market caps, sectors, geographies. This is how we personally invest our incremental dollars. And returns have been great, with an annualized return of 24.83% since inception. That compares quite favorably with the S&P 500 at 17.65% and the MSCI of 12.12%. The Fund has a 5-Star Overall Morningstar rating as of 12/31/2021.

For the period ended 12/31/2021, Baron WealthBuilder Fund received a 5-Star Overall Morningstar Rating™ and 5-Star 3-Year Rating. The Morningstar Ratings are based on the Morningstar Risk-Adjusted Return measures of 174 and 174 funds in the category, respectively. This Morningstar Rating is for the Institutional share class only; other classes may have different performance characteristics.

Morningstar calculates the Morningstar Allocation-85%+ Equity 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.

Personally, I think it's more important to look at the risk/return ratio. The Fund’s 3-year alpha is 5.10% as of 12/31/2022, with a beta is 1.2 and Sharpe Ratio of 1.58. Its upside capture is 121% with a downside capture of only 94.6%. So it's doing everything we aimed to do from both a return and a risk factor standpoint.

With an active share of 84.8%, this Fund looks very different from the S&P 500 -- from what people think of as the market. Nearly 60% of the Baron WealthBuilder portfolio is held in small- and mid-sized businesses. It's weighted towards higher-growth sectors that we believe are competitively advantaged, such as Consumer Discretionary, IT, Healthcare, and Real Estate. It's weighted towards a geographical mix that favors growing established economies, with 85% in the U.S. and 15% in international markets, primarily in fast-growing emerging markets.

In the fourth quarter, a lot of the Funds in Baron WealthBuilder Fund beat their benchmarks. Baron Growth Fund had a great year both in absolute and relative basis. Our four foundational holdings -- Baron Growth, Baron Asset, Baron Small Cap, Baron Partners – meaningfully exceeded their comparable indexes. Combined with Baron Focused Growth Fund, they represent around (58%) of portfolio assets. Baron Growth Fund and Baron Small Cap Fund were up 5.56% and 4.69%, respectively, in the quarter. That compares to the Russell 2000 Growth Index, which was basically flat at 0.01%. In the mid-cap category, Baron Partners Fund and Baron Asset Fund were up 19.54% and 5.04%, respectively, compared to the 2.85% increase for the Russell Midcap Growth Index. Baron Focused Growth Fund was up 10.83% compared to the Russell 2500 Growth Index of 0.2%. To be fair, not all our Funds exceeded our benchmarks. Our large cap growth funds, our international funds, our sector funds all have a much greater weighting towards growthier sectors than their indexes. As a result, they trailed their comparable benchmarks.

We still feel confident in a lot of the companies and industries in which we invest. **Nuvei Technologies Corp.** and **Penn National Gaming, Inc.** are two examples. Nuvei is a payment processing platform for online merchants. It has great market positioning and high recurring revenue, and we believe it'll introduce new products and make strategic acquisitions to cross-sell to existing clients. Penn, a regional casino company, has had concerns around competition and increased margin pressure, mostly due to advertising. But we believe its great local asset presence and digital marketplace will bring a loyal customer base to its online games and sports wager assets.

Can you talk about the Fund's largest holding – Tesla, Inc.?

Michael Baron: Baron Capital has been closely associated with Tesla for many years, and we're proud of it. It's a company that we got right. Currently, it comprises around 9% of Baron WealthBuilder Fund.

We are not currently purchasing Tesla. Our last purchase occurred in 2016 at around $40 per share. Over the past two years or so, Baron Funds that owned it have probably sold around 20% to 25% of their existing positions. You shouldn't take that as less confidence in the business. We're actually more confident than we were in 2016. But for risk management reasons we have reduced our stake as the stock appreciated.

We are managing the position in Baron WealthBuilder Fund as well, by putting new flows into Funds that have a lower weighting of Tesla. This ability demonstrates the benefit of tax-efficient rebalancing. We're able to reduce the Tesla position without creating a taxable event, without selling.

We remain confident in the business. In the last quarter, the company delivered over 300,000 vehicles, a 71% growth in its vehicle delivery in a very difficult environment. Everywhere you look, you read about supply chain issues, about labor shortages. Tesla is growing, others are not. The move it made years ago to vertically integrate its business are paying off now, while others are struggling.

Margins are up to around 30% gross margins, 20% EBITDA margins, which is roughly three times greater than its competitors. We believe that, over time, Tesla will come out with less expensive products that no one will be able to compete with on performance or price.

Baron Growth Fund's annualized returns for the Institutional Shares as of December 31, 2021: 1-year, 20.15%; 5-years, 22.73%; 10-years, 17.01%; Since Inception (12/31/1994), 14.38%. Annual expense ratio for the Institutional Shares as of September 30, 2020 was 1.04%. The **Russell 2000 Growth Index's** annualized returns as of December 31, 2021: 1-year, 2.83; 5-years, 14.53; 10-years, 14.14%; Since Fund Inception (12/31/1994), 8.81%.

Baron WealthBuilder Fund's annualized returns for the Institutional Shares as of December 31, 2021: 1-year, 16.70%; 3-years, 37.40%; Since Inception (12/29/2017), 24.83%. Annual expense ratio for the Institutional Shares as of December 31, 2020 was 1.22%, but the net annual expense ratio was 1.11% (includes acquired fund fees of 1.06%, 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%. The **Morningstar Allocation—85%+ Equity Category**'s annualized returns as of December 31, 2021: 1-year, 17.56%; 3-years, 19.75%.; Since Fund Inception (12/29/2017), 10.86%.

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. For Baron WealthBuilder Fund, 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.

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: Specific risks associated with investing in smaller companies include that the securities may be thinly traded and more difficult to sell during market downturns. Even though **Baron Growth 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 WealthBuilder Fund** is a non-diversified fund because it invests, at any given time, in the securities of a select number of Baron mutual funds (the "Underlying Funds"), representing specific investment strategies. The Fund can invest in funds holding U.S. and international stocks; small-cap, small to mid-cap, large-cap, all-cap stocks; and specialty stocks. Each of the Underlying Funds has its own investment risks, and those risks can affect the value of the Fund's investments and therefore the value of the Fund's shares. To the extent that the Fund invests more of its assets in one Underlying Fund than in another, it will have greater exposure to the risks of that Underlying Fund. For further information regarding the investment risks of the Underlying Funds, please refer to the Underlying Funds' prospectus.

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.

Baron Growth Fund portfolio holdings as a percentage of total investments as of December 31, 2021, for securities mentioned are as follows: CoStar Group, Inc. – 4.4%; **ANSYS, Inc.** – 4.6%; **Iridium Communications, Inc..** – 3.4%; **Trex Company, Inc.**- 2.3%; **Guidewire Software, Inc.** – 1.2%; **Penn National Gaming, Inc.** – 3.1%; **Arch Capital Group Ltd.** – 4.2%; **Mirion Technologies US, Inc.** – 0.2%; **Velo3D, Inc.** – 0.3%; **Sweetgreen, Inc.** – 0.1%; **Schrodinger Inc.** – 0.2%; **Denali Therapeutics, Inc.** – 0.3%.; **Altair Engineering, Inc.** – 0.6%. **Warby Parker, Inc.** – 0.1%. **Pegasystems, Inc.** – 1.2%.

Baron Growth Fund owned no position in **Adaptive Biotechnology Corporation, SmartRent, Inc., Nuvei**

Technology Corp., or **Tesla, Inc.** as of December 31, 2021.

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

Holding	% Assets
MSCI, Inc.	10.3
Vail Resorts, Inc.	6.8
FactSet Research Systems, Inc	6.0
Gartner, Inc.	5.4
Choice Hotels International, Inc.	4.8
Ansys, Inc.	4.6
IDEXX Laboratories, Inc.	4.6
Bio-Techne Corporation	4.4
CoStar Group, Inc.	4.4
Arch Capital Group, Ltd.	4.2
Total	55.5

Baron WealthBuilder Fund Top 10 holdings as of December 31, 2021

Holding	% Assets
Baron Partners Fund - Institutional Shares	15.5
Baron Growth Fund - Institutional Shares	12.8
Baron Asset Fund - Institutional Shares	12.8
Baron Small Cap Fund - Institutional Shares	12.1
Baron Global Advantage Fund - Institutional Shares	6.3
Baron Opportunity Fund - Institutional Shares	5.8
Baron Fifth Avenue Growth Fund - Institutional Shares	5.8
Baron Real Estate Fund - Institutional Shares	5.0
Baron Focused Growth Fund - Institutional Shares	4.8
Baron Discovery Fund - Institutional Shares	4.4

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 **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.

Alpha measures the difference between a fund's actual returns and its expected performance, given its level of risk as measured by beta. **Beta** measures a fund's sensitivity to market movements. The beta of the market is 1.00 by definition. **Downside Capture** measures how well a fund performs in time periods where the benchmark's returns are less than zero.

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. Non-mutual fund products are available to institutional investors only.

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