



# Baron Global Advantage Strategy

June 30, 2018

## DEAR INVESTOR:

### PERFORMANCE

The Baron Global Advantage Strategy had another good quarter. Shares appreciated 5.69% (net of fees) in the quarter, exceeding its benchmarks, the MSCI ACWI Growth Index and the MSCI ACWI Index, by 3.43% and 5.16%, respectively. Year-to-date, the Strategy is up 13.10%, outpacing the MSCI ACWI Growth Index and the MSCI ACWI Index by 10.15% and 13.53%, respectively, during that period.

**Table I.**  
**Performance<sup>†</sup>**  
**Annualized for periods ended June 30, 2018**

	Baron Global Advantage Strategy (net) <sup>1</sup>	Baron Global Advantage Strategy (gross) <sup>1</sup>	MSCI ACWI Growth Index <sup>1</sup>	MSCI ACWI Index <sup>1</sup>
Three Months <sup>2</sup>	5.69%	5.86%	2.26%	0.53%
Six Months <sup>2</sup>	13.10%	13.38%	2.95%	(0.43)%
One Year	34.58%	35.24%	16.06%	10.73%
Three Years	17.10%	17.34%	10.22%	8.19%
Five Years	18.46%	18.62%	11.55%	9.41%
Since Inception <sup>3</sup> (May 31, 2012)	18.12%	18.25%	12.72%	11.30%

Similarly to the first quarter, this was a solid, all-around effort. Roughly 70% of the relative outperformance came from stock selection, with 34 of the portfolio's holdings increasing in value. Digging deeper, 21 of the 34 investments rose double digits (in percentage terms), 15 were up over 20%, six of those were up over 30%, and three were up 50% or more. **Amazon, Yext, Constellation Software, Facebook, and AxoGen** all contributed over 50 basis points to absolute returns, with **Kotak Mahindra Bank, Mellanox, Gemphire Therapeutics, and Take-Two Interactive Software** contributing over 40 basis points each. On the other side of the ledger, our recent forays into Latin America appear to have been poorly timed, as Argentinian stock

exchange **Bolsas y Mercados Argentinos**, and Brazilian payment processing company **PagSeguro Digital** saw significant declines in their share prices, which were further exacerbated by weaknesses in the Peso and the Real.

The Strategy continues to benefit from what clearly has been a favorable environment for the way in which we invest. By this, we don't mean growth over value or large cap over small cap or this sector over that sector. We tend to do well when investors focus on business fundamentals and are willing to estimate a company's intrinsic value by looking at the long-term probabilities, which is what we do at all times. We tend to do less well in environments where these calculations are discarded in favor of the here and now, which usually happens during times of extreme uncertainty.

We exited the second quarter with almost 13% of the Strategy invested in China, which compares to less than 4% for the Strategy's indexes. We have just over 8% invested in India, over 6% invested in South Africa, 3.4% in Argentina, 2.2% in Brazil and 1.4% in Taiwan, for a total exposure to emerging markets (EM) of just over 34%.

Emerging markets has been a tough place to invest lately, with the macro narrative overshadowing strong earnings reports from most of our EM companies. Cross-border trade is increasingly more important to the global economy rising from 12% of global GDP in the 1960s to almost 30% in 2017. It is self-evident that heightened trade tensions are bad for everyone, and emerging markets' economies, which are perceived as more fragile, bear the brunt of the investor concerns and increased volatility. Although much of the tension has been in the form of tough talk, especially with regard to China, (vs. action, of which there has been relatively little), the markets hate uncertainty, and this tension, if nothing else, is generating uncertainty.

Over in Brazil and Argentina, the long-expected credit tightening, coupled with a rise in oil prices, resulted in political/financial crises that, again, generated uncertainty that spooked investors in these markets.

We don't particularly like what is going on and have no particular insight on how this will play out. Our admittedly simple view is that this is a short-term challenge, which will be overcome in time (as all short-term

*For Strategy reporting purposes, the Firm is defined as all accounts managed by Baron Capital Management, Inc. ("BCM") and BAMCO, Inc. ("BAMCO"), registered investment advisers wholly owned by Baron Capital Group, Inc. As of June 30, 2018, total Firm assets under management are approximately \$28.3 billion. Gross performance figures do not reflect the deduction of investment advisory fees and any other expenses incurred in the management of the investment advisory account. Actual client returns will be reduced by the advisory fees and any other expenses incurred in the management of the investment advisory account. A full description of investment advisory fees is supplied in our Form ADV Part 2A. Valuations and returns are computed and stated in U.S. dollars. Performance figures reflect the reinvestment of dividends and other earnings. The Strategy is currently composed of one mutual fund managed by BAMCO. The Strategy invests mainly in growth companies of all sizes located throughout the world. BAMCO and BCM claim compliance with the Global Investment Performance Standards (GIPS®). To receive a complete list and description of the Firm's Strategies or a GIPS-compliant presentation please contact us at 1-800-99BARON.*

<sup>†</sup> The Strategy's historical performance was impacted by gains from IPOs and/or secondary offerings. There is no guarantee that these results can be repeated or that the Strategy's level of participation in IPOs and secondary offerings will be the same in the future.

<sup>1</sup> The MSCI ACWI indexes cited are unmanaged, free float-adjusted market capitalization weighted indexes reflected in US dollars. The MSCI ACWI Growth Index Net USD measures the equity market performance of large and mid cap growth securities across developed and emerging markets. The MSCI ACWI Index Net USD measures the equity market performance of large and mid cap securities across developed and emerging markets. The indexes and Baron Global Advantage Strategy include reinvestment of dividends, net of foreign withholding taxes, which positively impact the performance results.

<sup>2</sup> Not annualized.

<sup>3</sup> The Strategy has a different inception date than its underlying portfolio, which is April 30, 2012.



# Baron Global Advantage Strategy

challenges have in the past). We think common sense and rational behavior will prevail when all's said and done, because the alternative is too unpalatable to all. We believe that this too shall pass, and investors will once again focus on fundamentals and long-term probabilities for businesses in emerging markets, which is (as we said above but think is worth repeating) how we always invest and when we tend to do best.

Paul Samuelson, the first American to win a Nobel Prize in Economics, famously said that "we have only one sample of the past," meaning that far more things could have happened than did happen. While "pattern recognition" is one of the most commonly used tools in the craft of capital allocation, there is only so much we can learn from studying history. We think it is equally important to realize that we will get only one sample of the future! The pattern that we will experience is just one of the infinitely many possible ones, and it will NOT be the one that we "expect" statistically. It will be something different, possibly very different. What matters isn't the best possible outcome or the worst possible outcome or even the single most likely outcome. What matters is the range of outcomes and their respective probabilities and consequences. This is how we think about all our investments.

There have been a lot of crises, corrections, and challenges over the last 20 years. In the U.S. alone, we've had the bursting of the internet bubble, followed by 9/11 and global wars on terror (not to mention a painful economic recession), bursting of the real estate bubble and a corresponding financial crisis, which shook our markets to the core, and a few history-defining elections, which currently make us question who we really are. And that's just us. It seems Europe has been in a perpetual crisis. First the debt crisis brought on by PIGS (Portugal, Ireland, Greece, and Spain), Russia invading Ukraine and annexing Crimea, refugee crisis, Brexit, nationalists and separatists gaining popularity in Spain and Italy, and so on. Latin America? As in Brazil, Argentina (let alone Venezuela) – we don't even think we need to go there. Asian currency crises, China's hard-landing (remember those ghost towns?), instability on the Korean peninsula, and so on...

While all of this is going on, Alibaba went public in September of 2014 with an IPO price of \$68 per share and was trading around \$210 in late June of this year. Also trading around \$210 per share is Facebook, which IPO'd in May of 2012 at \$38. Over the last 20 years, Housing Development Finance Corporation of India rose from approximately 20 rupees per share to 1,966 rupees per share. And then, of course, there is Amazon, which listed its shares on Nasdaq in 1997 and whose market value recently exceeded \$900 billion for a tidy return of just over... 123,000%.

**Table II.**  
**Top contributors to performance for the quarter ended June 30, 2018**

	Quarter End Market Cap (billions)	Percent Impact
Amazon.com, Inc.	\$824.8	0.82%
Yext, Inc.	1.9	0.59
Constellation Software, Inc.	16.4	0.58
Facebook, Inc.	562.7	0.56
AxoGen, Inc.	1.9	0.51

Shares of **Amazon.com, Inc.** rose 17% during the quarter. Amazon continues to benefit from its flywheel strategy, where more participation from Prime members drives greater loyalty and purchasing on Amazon.com, in a prime example (pun intended) of the benefits of the network effect. Paid Prime membership has exceeded 100 million households globally. While penetration of e-commerce is rising, Amazon continues to increase its total addressable market at an unprecedented pace. Health care spending in the U.S. is over \$3 trillion annually, with \$450 billion spent on prescription drugs and another \$200 billion spent on medical devices. We think Amazon's opportunity here could be significant over time. In the meantime, AWS remains the runaway leader in the vast, and still rapidly growing, cloud infrastructure market by a wide margin.

**Yext, Inc.** is the leader in digital information and knowledge management for businesses. Through its cloud-based software offering, the company is attempting to become the digital knowledge platform which allows businesses to manage all their digital information. Shares rose 53% on strong financial results and an improving outlook. We believe Yext is in the very early innings of growth and enjoys a large and open market opportunity with an attractive, high-visibility, recurring revenue business model. Most of Yext's senior management are veterans of Salesforce.com, a company we have admired for years and in which other Baron strategies are invested. We believe there is an opportunity for this team to build another world class business, and are excited to see what they will do over the next few years.

Shares of **Constellation Software, Inc.** appreciated 14% in the quarter following an upbeat investor day, which we attended in Toronto. Constellation Software is a diversified owner of high-quality vertical market software businesses. We like Constellation Software's capital allocation discipline, and recently we've been impressed with its higher pace of acquisitions following last year's decision to increase the full- and part-time acquisition team. We believe that capital investment can triple over the medium term if Constellation Software can successfully encourage its 200-odd subsidiary units to acquire in-vertical. Considering the attractive return profile of acquiring niche vertical-market software, we believe this will lead to significant cash flow growth for shareholders.

Shares of **Facebook, Inc.**, the world's largest social network, appreciated 21% on strong first quarter results, rebounding from concerns related to data leaks to Cambridge Analytica and other third parties. The company is the only "must have" advertising platform in social networking for brands, and the largest beneficiary of continued, healthy consumer engagement. It utilizes its leadership position in mobile to provide global advertisers targeted marketing capabilities at scale, which we believe will be unaffected by recent privacy concerns and regulatory risks.

**AxoGen, Inc.** is a leading developer of surgical solutions for peripheral nerve damage and nerve repair, including Avance Nerve Graft and AxoGuard Nerve Connector. The stock rose 38% after the company raised cash in a secondary offering, possibly due to new shareholders gaining an appreciation for the investment merits and building positions as well as outperformance of small-cap growth companies in the medical device sector. We continue to believe AxoGen has a unique product portfolio offering and an expanding market opportunity in nerve repair applications.

**Table III.**  
**Top detractors from performance for the quarter ended June 30, 2018**

	Quarter End Market Cap or Market Cap When Sold (billions)	Percent Impact
Bolsas y Mercados Argentinos S.A.	\$ 0.9	−0.69%
PagSeguro Digital Ltd.	9.1	−0.65
FANUC Corp.	41.2	−0.37
Cloudera, Inc.	2.3	−0.29
Taiwan Semiconductor Manufacturing Company Ltd.	189.6	−0.27

**Bolsas y Mercados Argentinos S.A.** (BYMA) is Argentina's only vertical integrated stock exchange and sole custodian for equity securities. Shares of BYMA declined 39%, largely due to the deterioration in the country's macroeconomic conditions and a significant devaluation of the local currency, which outweighed strong bottom-up trends reported by the company in its most recent quarter. We remain excited about BYMA's long-term growth prospects because the country's capital markets are underdeveloped, there is an improved regulatory framework for listings, and there are still unexploited revenue opportunities for the company, in our view.

**PagSeguro Digital Ltd.** is a Brazilian payment processor, focused on facilitating small and micro merchants in Brazil to accept forms of credit, debit, and digital currency transactions. For a majority of its merchant customers, PagSeguro's simple product offering – an internet-enabled payment device along with a mobile wallet – allows the merchant to instantly accept credit transactions without the need of a bank account. The shares declined 26% after the company unexpectedly announced a secondary offering. We believe that PagSeguro's platform, advertised widely across the country because of the media relationships of a strong corporate parent, has the potential to dramatically lower transaction costs for these small merchants. Over time, we expect PagSeguro to gain significant market share from the bank-controlled incumbent payment processors who continue to underserve this growing merchant community.

Shares of **FANUC Corp.** declined 22% for the period held. The global machine tool industry has begun to experience early signs of cyclical weakness. Growing global trade tensions have also weighed on the stock given its significant presence in both the U.S. and China. This was a small, introductory position in the Strategy, and given the short-term uncertainty and a large list of new ideas, we decided to step to the sidelines and redeploy capital.

**Cloudera, Inc.** provides enterprise data management solutions for machine learning and advanced analytics, leveraging the Hadoop architecture through its hybrid open-source software model that combines the benefits of the open source community with proprietary value-added enterprise software. Cloudera's shares declined 28% for the period held after management announced a sales reorganization and provided annual guidance that was significantly below expectations. These announcements reduced our confidence in the company's long-term competitive advantage over other big data and Hadoop distribution players. Ongoing sales adjustments and potential slower growth, specifically within Cloudera's largest accounts, has increased the likelihood of significant execution risk. As a smaller holding, we decided the prudent course of action was to exit our position and redeploy resources to higher conviction investments.

**Taiwan Semiconductor Manufacturing Company Ltd.** is the leading designer and manufacturer of integrated circuits and wafer semiconductor devices in the world. Shares were down 14% during the quarter due to concerns over slowing smartphone growth, uncertainties around the broader technology CapEx cycle, and cryptocurrency mining outlooks. We own the stock due to its clear technology leadership, proven execution track record, and promising new growth drivers in high performance computing and Internet of Things related applications.

## PORTFOLIO STRUCTURE

The portfolio is constructed on a bottom-up basis with the quality of ideas and conviction level having the most significant roles in determining the size of each individual investment. Sector or country weights tend to be an outcome of the portfolio construction process and are not meant to indicate a positive or a negative "view."

The top 10 positions represented 41.7% of the Strategy, and the top 20 were 66.0%. 99.1% of the Strategy's assets are invested in stocks in the Information Technology, Consumer Discretionary, Financials, and Health Care sectors, as classified by GICS, with over half of the assets invested in companies that are domiciled outside of the U.S.

**Table IV.**  
**Top 10 holdings as of June 30, 2018**

	Quarter End Market Cap (billions)	Quarter End Investment Value (millions)	Percent of Net Assets
Naspers Limited	\$111.7	\$5.5	6.4%
Amazon.com, Inc.	824.8	4.3	4.9
Facebook, Inc.	562.7	4.2	4.8
Alibaba Group Holding Limited	475.2	3.9	4.5
Alphabet Inc.	779.2	3.7	4.3
Constellation Software, Inc.	16.4	3.3	3.8
EPAM Systems, Inc.	6.6	3.0	3.4
Housing Development Finance Corporation Limited	46.8	2.9	3.4
Activision Blizzard, Inc.	58.1	2.8	3.2
Mellanox Technologies Ltd.	4.5	2.6	3.0

## EXPOSURE BY COUNTRY

**Table V.**  
**Percentage of securities by country as of June 30, 2018**

	Percent of Net Assets
United States	48.1%
China	12.8
India	8.1
South Africa	6.3
Israel	5.0
Netherlands	5.0
Canada	3.8
Argentina	3.4
Japan	2.4
Brazil	2.2
Taiwan	1.4
Australia	0.6



# Baron Global Advantage Strategy

## RECENT ACTIVITY

During the quarter, we initiated five new investments (though only The Stars Group was over 1% of the Strategy) and added to 25 existing positions, as we put the Strategy's inflows to work. We also closed out five investments, none of which were able to graduate into "core" holdings. We exited the June quarter with 45 holdings, unchanged from the prior period.

**Table VI.**  
Top net purchases for the quarter ended June 30, 2018

	Quarter End Market Cap (billions)	Amount Purchased (millions)
Facebook, Inc.	\$562.7	\$2.1
The Stars Group Inc.	6.1	1.3
Veeva Systems Inc.	11.0	1.2
PagSeguro Digital Ltd.	9.1	0.9
Illumina, Inc.	41.1	0.8

We let the size of our position in **Facebook, Inc.**, the world's largest social network, get diluted in the first quarter to the point where it was no longer a top 10 holding. It seemed like a prudent thing to do in the face of the Cambridge Analytica debacle and the following cross-continent, public apology tour (which we frankly thought was well executed) by the company's management. Though Facebook is hardly out of the woods and we fully expect more negative headlines about potential data breaches, this only underlines how unique and important the company's offering has become. Social Media ad engagements are rising (three times that of 18 months ago, according to Mary Meeker's most recent internet report). Personal AND collective data provide for better consumer experiences, improve engagement and drive growth and... lead to privacy concerns and regulatory scrutiny. Bad actors and unintended consequences will never go away, but they will be managed. In the meantime, "product discovery" on Facebook and especially Instagram are starting to rise significantly with data driven personalization/recommendations just starting to show up. We expect to see another leg of growth when that starts to scale...

**The Stars Group Inc.** is a leading provider of technology-based products and services in the global gaming and interactive entertainment industries. It owns gaming and related consumer businesses and brands, including PokerStars, Full Tilt, BetStarts, and StarsDraft. Online gaming is a \$42 billion industry globally, and is expected to grow to \$57 billion by 2022. The company is already the leader in online poker globally, with over 60% market share and recently purchased Skybet, the fastest growing sports betting company in the U.K., the largest sports betting market in the world. The combined company's competitive advantages going forward will stem from: 1) its ability to cross-sell products by having leading sports betting, casino, and online poker capabilities cost effectively; 2) its leadership position on technology with regard to mobile and social gaming; and 3) Skybet's unique relationship with Sky Television in Europe with deep integration into Sky programming. We believe that investors underappreciate the capabilities of the combined companies and Skybet's mobile leadership. We believe the combined company can grow at a high rate for several years and is poised to be the global leader in online wagering. As the U.S. market opens up to online wagering, we expect The Stars Group to be well positioned for market entry through strategic partnerships.

**Veeva Systems Inc.** is the leading provider of cloud-based solutions targeted at the life sciences industry. Veeva offers customer relationship management, content, collaboration, and data management solutions tailored mostly to the life sciences industry. Most recently, Veeva reported another set of excellent financial results. Management noted traction with newer solutions, while the more penetrated, commercial cloud products continued to show healthy growth rates. Though management is investing in the new products growth within life sciences and in new verticals, Veeva continues to deliver on profitability, delivering more than 27% of subscription revenue growth last year while maintaining EBITDA margins and year-over-year growth of more than 30%. With Vault now serving as the growth engine for the company, we expect that the product line will create additional, multi-year growth opportunities for the company, and believe it can be a significantly larger company by capturing greater share, over time, in new subsegments within and beyond life sciences.

**PagSeguro Digital Ltd.** is a Brazilian payment processor, focused on facilitating small and micro merchants in Brazil to accept forms of credit, debit, and digital currency transactions. For a majority of its merchant customers, PagSeguro's simple product offering – an internet-enabled payment device along with a mobile wallet – allows the merchant to instantly accept credit transactions without the need of a bank account. We believe that PagSeguro's platform, advertised widely across the country given the media relationships of a strong corporate parent, has the potential to dramatically lower transaction costs for these small merchants. Over time, we expect PagSeguro to gain significant market share from the bank-controlled incumbent payment processors who continue to underserve this growing merchant community.

**Illumina, Inc.** is the leading provider of next generation DNA sequencing instruments and consumables. Illumina has been a core investment in this Strategy since its inception. We continue to believe Illumina will benefit from increased adoption of DNA sequencing in clinical applications, such as cancer diagnosis and treatment. We are also excited about the positive optionality that exists from Illumina's spin outs Helix and Grail.

**Table VII.**  
Top net sales for the quarter ended June 30, 2018

	Market Cap When Sold (billions)	Amount Sold (millions)
Cboe Global Markets, Inc.	\$11.7	\$1.1
FANUC Corp.	41.2	0.9
Dropbox, Inc.	13.1	0.8
AnaptysBio, Inc.	2.0	0.5
Cloudera, Inc.	2.3	0.5

After increasing our holdings in **CBOE Global Markets, Inc.** in the prior quarter, we decided to eliminate our investment as shifting market conditions led to a decline in VIX trading activity, leaving the growth trajectory uncertain and causing us to lose conviction in the original investment thesis for CBOE.

**FANUC Corp.** is a world leader in design and development of CNC systems, lasers, robot systems, and nano-bots. The global machine tool industry has begun to experience early signs of cyclical weakness. Growing global trade tensions have also weighed on the stock given its significant presence in both the U.S. and China. This was a small, introductory position in the

Strategy, and given the short-term uncertainty and a large list of new ideas, we decided to step to the sidelines and redeploy capital.

**Dropbox, Inc.** is a leading storage provider enabling customers to access and collaborate on their most important information anytime from any device. The company has an installed base of 500 million users and has ample room to grow paid subscribers and convert them to higher value customers by developing innovative collaboration products. We sold our position in Dropbox when shares spiked on some unsubstantiated rumors, and we took the opportunity to bank profits and move on to other ideas.

**AnaptysBio, Inc.** is a biotech company with a novel antibody discovery platform that allows the company to modulate previously untargetable immunological proteins that have compelling biological rationale as causative bad actors in their underlying disease pathology. Leading this foray is ANAB020, targeting a IL-33 in atopic dermatitis, peanut allergy, and asthma. Recent events have led to stock underperformance given an ambiguous trial result in treatment of anaphylaxis caused by peanut allergies and the company's more hesitant messaging regarding top-line asthma data this fall. We chose to take the losses and step to the sidelines. We are watching this company closely and may return to it sometime in the future.

**Cloudera, Inc.** provides enterprise data management solutions for machine learning and advanced analytics. Cloudera's shares declined 28% for the period held after management announced a sales reorganization and provided annual guidance that was significantly below investor expectations. As a smaller holding, we decided the prudent course of action was to exit our position and redeploy resources to higher conviction investments.

## OUTLOOK

Last year proved to be especially rewarding for global growth investors and many of our companies have performed exceedingly well, with the Strategy's shares appreciating almost 50%. With another strong six months in the books, it has undeniably been a favorable environment for the way in which we invest. While we observe a noticeable pick up in volatility, and are repeatedly told by talking heads that, with each passing day, a pullback or a correction becomes more likely, we continue to do what we do, and see

favorable fundamentals for most of our investments. Valuations, though no longer cheap, remain reasonable in our view, especially when compared to available alternatives. Moreover, the earnings outlook for 2018 remains optimistic. More relevant to our portfolio, e-commerce growth and spending on digital transformations are continuing to accelerate, with spending on cloud computing growing over 60%, and even faster than that in Asia. The digitization phenomenon that we believe will dominate corporate spending for years to come is starting to reach inflection points in many new areas where not only media and retail, but health care, transportation, and consumer banking are in the midst of full blown disruptions. We believe this should continue to favor many of the companies in which we are invested.

Every day we live and invest in a world full of uncertainty. Fed policy, potential trade wars, the health of EM economies, energy prices, global politics, terrorism – these are all serious challenges with clearly uncertain outcomes. History would suggest that most will prove passing or manageable. The business of capital allocation (or investing) is the business of taking risk, managing the uncertainty, and taking advantage of the long-term opportunities that those risks and uncertainties create. We believe that our process is the right one and that it will enable us to make good investment decisions over time.

Our goal remains to maximize long-term returns without taking significant risks of permanent loss of capital. We focus on identifying and investing in what we believe are unique companies with sustainable competitive advantages that have the ability to compound capital at high rates of return for extended periods of time. We are optimistic about the long-term prospects of the companies in which we are invested and continue to search for new ideas and investment opportunities.

Sincerely,



Alex Umansky  
Portfolio Manager

*The performance of accounts in the Strategy may be materially different at any given time. Differences that may affect investment performance include cash flows, inception dates, and historical prices. Positions may not be the same or may be traded at different times. In addition, accounts in the Strategy may be pursuing similar investment strategies, but may have different investment restrictions.*

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. This may result in greater share price volatility. Securities of small and medium-sized companies may be thinly traded and more difficult to sell. The Strategy may not achieve its objectives. Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

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