Dear Baron Durable Advantage Fund Shareholder:

Performance

We were pleased with the second quarter results.

Baron Durable Advantage Fund (the "Fund") gained 22.2% (Institutional Shares) during the second quarter, which was better than the 20.5% gain for the S&P 500 Index (the "SPX"), the Fund's benchmark. The Fund outperformed nicely on the way up in 2019 (41.1% vs. 31.5%), declined 3.7% less during the first quarter on the way down, and now gained 1.6% more during the second quarter on the way back up.

Table I.
Performance
Annualized for periods ended June 30, 2020

	Baron Durable Advantage Fund Retail Shares[1,2]	Baron Durable Advantage Fund Institutional Shares[1,2]	S&P 500 Index[1]
Three Months[3]	22.11%	22.17%	20.54%
Six Months[3]	2.54%	2.68%	(3.08)%
One Year	16.55%	16.84%	7.51%
Since Inception (December 29, 2017)	12.27%	12.54%	8.23%

The second quarter saw one of the strongest stock market recoveries in history with the SPX up 20.5% in the quarter and up 39.3% from the trough reached on March 23. The Fund is now up 2.7% year-to-date ("YTD"), 576bps ahead of the 3.1% decline for the SPX. As is typically the case, the outperformance in the quarter was due to stock selection, which was responsible for 442bps of our 163bps of excess returns (as sector allocation and cash caused a 284bps headwind).

The quarterly results were driven by good gains across the portfolio. We outperformed in most sectors, led by a 12.7% excess return in Financials, which contributed 148bps to our outperformance, followed by a 10.1% excess return in Health Care, contributing 157bps to our outperformance. We also outperformed by 9.7% in Industrials, 8.7% in Consumer Staples, and 4.5% in Communication Services, which contributed 169bps to our outperformance combined. Our relative returns were also helped by not investing in Utilities, while not owning Energy and Consumer Discretionary hurt us since these sectors were among the three top performing sectors of the SPX in the second quarter. Our returns were also strong across market caps, led by a 6.1% excess return in large caps, which were responsible for 214bps of our outperformance, followed by a 3.7% excess return in giant caps (responsible for 144bps of our outperformance).

ALEX UMANSKY

PORTFOLIO MANAGER

Retail Shares: BDAFX
Institutional Shares: BDAIX
R6 Shares: BDAUX

Looking under the hood, we had 16 investments that were up at least 25% during the quarter, 8 of which were up 30% or more: **ASML**, **Adobe**, **Fair Isaac**, **Facebook**, **S&P Global**, **Accenture**, **Iqvia**, and **TE Connectivity**. We had a very consistent quarter with no big outliers on either side and just one decliner, **CME Group**, which was down modestly due to headwinds caused by the reduced levels of market volatility.

Despite the strong market recovery from the bottom on March 23, (SPX is up 39.3% since then), the moves in prices of stocks were far from uniform. At one extreme, areas that were hit the hardest by the COVID-19 shutdowns are still down meaningfully for the year. Hotels, resorts & cruise lines are down 51% YTD, aerospace & defense companies are down 25%, Energy stocks are down 35% and Financials are down 24%. On the other side, companies with resilient business models that are considered to be beneficiaries from accelerating digital transformation trends, are up significantly. For example, companies in the application software space are up 25% YTD.

Companies that we own in this Fund, have been mostly on the right side of this dichotomy, largely due to the strength in their business fundamentals, which have proven to be more resilient in the near term, with a potential for acceleration as we come out of COVID-19.

Performance listed in the table above is net of annual operating expenses. Annual expense ratio for the Retail and Institutional Shares as of September 30, 2019 was 6.22% and 4.91%, respectively, but the net annual expense ratio was 0.95% and 0.70% (net of the Adviser's fee waivers), respectively. 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, 2030, 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.

1 The index is unmanaged. The index performance is not Fund performance; one cannot invest directly into an index. The S&P 500 Index measures the performance of 500 widely held large cap U.S. companies. The index and the Fund are with dividends, which positively impact the performance results.

2 The performance data in the table does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or redemption of Fund shares.

3 Not annualized.

- **Alphabet:** *"Long term acceleration of movement from businesses to digital services… These changes will be significant and lasting… cloud is an obvious area. If you have data centers, these are fixed costs…"*
- **Mastercard**: *"[T]here's a few things that are pretty obvious, pretty clear, and are coming through in the number[s] already… And the first is this push to e-commerce and digital… People are getting used to consuming via delivery service, where they might have gone outside before… behavior patterns moving towards digital"*.
- **Microsoft** saw its Azure cloud business grow revenues 61% year-over-year in the first quarter, while its CEO, Satya Nadella, suggested potential acceleration due to COVID-19: *"**Two years' worth of digital transformations in two months**…COVID-19 is a tailwind to Azure over 2-3 years for sure… there's no question that moving to the public cloud, even in a time like this, is just capital efficient… for any business… one of the smartest things that anyone can do… is to transition to the efficient frontier as quickly as possible so that they can have more agility, more elasticity, and better unit economics coming out of this or even while you're in this crisis. **So, I think the migration to the cloud is absolutely a secular shift**."*
- **Adobe** reported that one of its most important KPIs, Digital Media annualized-recurring-revenue was up 23% year-over-year as it also benefited from the accelerating pace of digital transformations. Its CEO, Shantanu Narayen, said during the conference call: *"New normal is going to be people working in remote locations, engaging more digitally, making sure that digitization continues to be a really important phenomenon… the Document business… **It just accelerated and we think that that's a trend that will be durable**."*

The acceleration in these tailwinds, when combined with the Fed's overwhelming response to COVID-19, which has led to a reduction in long-term interest rates and equity risk premiums, has driven up the intrinsic value of many of the businesses we own. Cash flows will grow faster for longer and are discounted to present value at lower discount rates. In a post-COVID-19 world, digitization will become crucial for survival. COVID-19 has proven that companies that are either digitally native or that have already digitally adapted and transformed will thrive, while the rest may be left behind.

While the level of economic and market uncertainty remains elevated, we believe that the increased pace of disruptive change will benefit many of our businesses, expand their competitive moats, and accelerate the growth in their intrinsic values. Our experience in uncovering the best ones and our willingness to hold them for the long term should enable us to continue to generate opportunities to outperform over the long term.

Table II.
Top contributors to performance for the quarter ended June 30, 2020

	Quarter End Market Cap (billions)	Percent Impact
S&P Global Inc.	$ 79.4	1.65%
Adobe Inc.	208.8	1.64
Microsoft Corporation	1,543.3	1.56
Moody's Corporation	51.5	1.50
Accenture plc	136.8	1.16

S&P Global Inc. provides credit ratings, indexes, data, and analytics to the financial and commodities markets. Shares of S&P Global increased 34.8% in the second quarter as falling interest rates and stimulus measures from the Federal Reserve drove a strong corporate bond issuance market. Non-financial investment grade issuance hit a quarterly record by a wide margin after more than doubling, and high yield issuance was also meaningfully higher. Equity market appreciation provided a boost to the Indexes segment as well. We continue to own the stock due to S&P Global's long runway for growth as it benefits from the secular trends of increasing bond issuance, growth in passive investing, and demand for data and analytics, while enjoying meaningful and durable competitive advantages.

Adobe Inc. is a leading software company that offers creative and document cloud solutions for the digital media market; and marketing, advertising, and analytics cloud solutions for the digital experience market. Shares appreciated 36.7% during the quarter as the company's business model is proving resilient to COVID-19 market disruptions. We believe that Adobe's robust growth is driven by some of the strongest technological shifts of our generation, including digitization of content, the growing adoption of online advertising, the transition to mobile, and the widespread adoption of video. We believe that the opportunity ahead of Adobe is large and expanding with a total addressable market ("TAM") estimated at over $100 billion, and we view Adobe as the best positioned company to attack that TAM as it benefits from its leadership position.

Microsoft Corporation is a software mega cap that has successfully pivoted from the client server and PC era to today's world of digital transformation and cloud. Microsoft is a cloud leader through its Azure, Office 365, Dynamics 365, and Teams offerings, among others. Shares increased 29.4% during the second quarter as Microsoft's transition to cloud-based subscriptions has made its business more durable in downturns, with 90% of its commercial revenue base paid on an annuity basis, while also standing to benefit from the acceleration of digital transformation trends driven by the pandemic. We also believe that Microsoft's competitive advantages are strong and durable as it benefits from the long reach of its sales channel, its differentiated hybrid cloud offering, and its large installed base of enterprise customers.

Moody's Corporation provides credit ratings, financial intelligence, and analytical tools to assist businesses in making decisions. After declining in the first quarter, shares rebounded 30.0% during the second quarter as falling interest rates and stimulus measures from the Federal Reserve drove a strong corporate bond issuance market. Non-financial investment grade issuance hit a quarterly record by a wide margin after more than doubling, while high-yield issuance was also meaningfully higher. We continue to own the stock based on our belief that the company benefits from numerous secular growth trends, such as bonds taking share in the credit pie, growth in passive investing, and demand for data and analytics. Moody's operates in attractive oligopoly markets where it enjoys meaningful competitive advantages and pricing power.

Accenture plc provides consulting and technology services to corporate clients around the world. The shares rebounded 32.2% during the second quarter from their decline in the prior quarter as the pandemic-related impact wasn't as bad as feared by investors. Quarterly revenue and earnings growth slowed but exceeded expectations, and management was optimistic about longer-term growth prospects driven by the acceleration in digital transformation projects. We believe Accenture is well equipped to help its clients adapt to the changing economic environment and will continue gaining share in a large global market.

Table III.
Top detractors from performance for the quarter ended June 30, 2020

	Quarter End Market Cap (billions)	Percent Impact
CME Group, Inc.	$58.3	–0.02%

CME Group, Inc. is the world's largest and most diversified derivatives marketplace. Following a very strong first quarter, trading volume slowed significantly in the second quarter, causing the shares to underperform, declining 5.6% in the second quarter. Lower market volatility and a growing expectation that interest rates will remain "lower for longer" reduced the need to hedge with CME's futures and options, leading to a 16% drop in trading volume. We continue to own the stock because CME should benefit from episodic volatility spikes and increasing adoption of exchange-traded futures. We also believe that CME operates a strong business with a wide structural moat driven by the network effects between buyers and sellers on its marketplaces (the value of a marketplace is a function of its liquidity, which rises with the number of participants), its capital-light requirements, and its experienced management team that allocates capital well.

Portfolio Structure

The Fund's portfolio is constructed on a bottom-up basis with the quality of ideas and conviction level (rather than benchmark weights) determining the size of each individual investment. Sector 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 46.4% of the Fund, the top 20 were 74.9%, and we exited the quarter with 35 investments. Information Technology and Health Care, our biggest exposures, represented 53.8% of the Fund. Financials, Communication Services, Industrials, Real Estate, and Consumer Staples represented another 40.3% of the Fund with cash and a new addition classified under Materials, as the remaining 5.9%.

Table IV.
Top 10 holdings as of June 30, 2020

	Quarter End Market Cap (billions)	Quarter End Investment Value (thousands)	Percent of Net Assets
Microsoft Corporation	$1,543.3	$673.6	5.6%
Adobe Inc.	208.8	647.7	5.4
S&P Global Inc.	79.4	603.6	5.0
Moody's Corporation	51.5	592.9	4.9
AstraZeneca PLC	138.8	589.8	4.9
Danaher Corporation	125.2	552.4	4.6
Facebook, Inc.	647.5	507.0	4.2
Accenture plc	136.8	498.6	4.2
Thermo Fisher Scientific Inc.	143.1	468.5	3.9
Mastercard Incorporated	296.8	441.8	3.7

Recent Activity

We initiated two new investments during the quarter: **Ecolab Inc.** and **Fair Isaac Corporation**. We also took advantage of flows into the Fund and added to 18 existing holdings. As mentioned in our first quarter letter, we continued using **Apple, Inc.** as a source of cash, finally exiting our position during the quarter as we saw better opportunities in other, higher conviction ideas.

Table V.
Top net purchases for the quarter ended June 30, 2020

	Quarter End Market Cap (billions)	Amount Purchased (thousands)
AstraZeneca PLC	$138.8	$306.8
Facebook, Inc.	647.5	225.7
MSCI, Inc.	27.9	150.4
Charter Communications, Inc.	121.5	128.9
Ecolab Inc.	57.5	120.5

We initiated a position in **Ecolab Inc.** during the quarter. Ecolab is a global leader in cleaning, sanitizing, and water treatment. The company delivers programs, products, and services to promote safe food, maintain clean environments, optimize water and energy use, and develop and improve efficiencies for customers in food, health care, energy, hospitality, and industrial markets in more than 170 countries around the world. We think that Ecolab will benefit from an increase in "hygiene awareness" as customers ranging from hotels to restaurants, office buildings and manufacturing facilities implement additional cleaning and sanitation protocols in response to COVID-19. Ecolab is a technology leader that sells solutions based upon its strong value proposition to the customer where they lower total operating cost through reducing the usage of water, energy, or labor. The company's differentiated sales and service approach ensures that customers get the best results from its products as well as establishes relationships to sell additional products. We think that the company has substantial opportunity to grow organically, with only 10% share of its estimated $13 billion addressable market. Despite near-term weakness from certain end markets due to COVID-19, we believe Ecolab's long-term growth trajectory is durable as the company is set to emerge stronger, maintaining its key role in the creation of hygiene solutions in a post-pandemic world.

During the quarter, we also initiated a position in **Fair Isaac Corporation** ("FICO"). FICO is a data and analytics company focused on predicting consumer behavior to help businesses manage and optimize their decision-making processes. FICO delivers its products and services through three operating segments. Scores (36% of 2019 revenue) offers a collection of sophisticated algorithms that provide a consistent measure of an individual's credit risk and is used by most major U.S. financial institutions to make consumer credit decisions; Applications (52% of 2019 revenue) provides pre-configured software modules targeting different business problems (largely for financial services companies), including fraud, marketing, customer management, collections, and account origination; and Decision Management Software (12% of 2019 revenue) enables clients to create their own custom decision management applications.

We believe that FICO has an attractive business model. The Scores business is the de-facto standard in the market, being used for around 90% of U.S. consumer credit lending decisions and more than 98% of total dollars for U.S. securitizations. As a result, the Scores segment has attractive economics with over 80% operating margins, extremely high incremental margins, limited capital needs, and strong free cash flow generation. The Software business (Applications and Decision Management Software) contains a number of strong franchises, but is currently under earning due to meaningful investment in re-platforming the business and transitioning to the cloud. Once completed, we believe that Software margins can materially expand. In addition, we are impressed by CEO Will Lansing and believe that he has done a great job of leading FICO since taking over as CEO in 2012.

Despite the remarkable performance over the last eight years, we believe that FICO has the potential to continue driving a durable mid-to-high single-digit revenue growth rate. Scores volume growth will fluctuate somewhat with the consumer credit cycle, but overall Scores growth will be driven by pricing optimization. After renegotiating contracts that had not allowed FICO to raise its price on FICO scores for decades, the company has spent the past few years implementing special price increases, and we believe that there is still a lot of room left to further increase pricing. Combining Scores led revenue growth, improved Software growth and margins once the cloud transition is complete, and management's shareholder friendly capital allocation approach, we believe that FICO will be a steady earnings compounder, which should drive solid returns for the stock over a multi-year period.

Table VI.
Top net sales for the quarter ended June 30, 2020

	Market Cap When Sold (billions)	Amount Sold (thousands)
Apple, Inc.	$1,226.0	$109.6

We decided to reallocate capital from **Apple, Inc.** to other, higher conviction ideas that we believe offer a better risk-reward profile. After the exceptional year Apple's stock had in 2019, rising 86% (while revenues declined 2%, EBITDA declined 6.5%, and EPS were flat), the stock price has risen above our estimate of Apple's intrinsic value, leading us to an earlier-than-anticipated exit.

Outlook

It almost feels like we have lived through a full market cycle during the last six months. From the market participants' vast optimism in early January to extreme pessimism in March, when futures were limit down practically every morning, and back to one of the biggest rallies in history during the last three months. Ironically, we believe that through it all, *what we don't know > what we do know* remains to be true. We are still in the very early stages of understanding of long-term implications of COVID-19.

"The World Just Doesn't End That Often" said Brian Rogers, the Chairman and Chief Investment Officer of T. Rowe Price during the Financial Crisis in 2008. We tend to agree. The market has clearly concluded that we will get through this, but we think it is also signaling that life and business may be very different.

Upon reflecting on the last six months, we made several observations:

- The heightened level of uncertainty will likely significantly increase the range of possible outcomes.
- Market participants appear to be even more short-term focused than usual.
- The performance of stocks has been largely bimodal. If the company is perceived as a beneficiary of COVID-19 or even just a clear survivor, its valuation seems to be less important.

The first two observations play into what we believe are our structural competitive advantages. Our focus on long-term ownership and our investment process in which we think of everything probabilistically. We believe that understanding the range of outcomes and their respective probabilities AND consequences is more important than knowing the best possible outcome or the worst possible outcome or trying to predict the most likely outcome. (Thank you, Michael Mauboussin!) We can't always anticipate every possible outcome, but it is our job to be as prepared as possible. While most investors are focused on figuring out the exact growth rate over the next one to two quarters, we are instead busy estimating the approximate growth rate over the next decade. The third and last observation, however, raises the probability that there will be a period, in which we will underperform. Sooner or later, there will be a vaccine and herd immunity, and people will start traveling again. Airlines, casinos, hotels, energy companies, and banks will rally, causing us to underperform during that period. We are okay with that. Note that unlike many investors, we don't view volatility as risk; we define as the probability of permanent loss of capital. As we look across our portfolio today and compare it to six months ago, we believe the intrinsic values of our holdings have risen, on average, more than the approximate 2.5% increase in their stock prices, increasing the probability that our portfolio will outperform over the long term.

It is our belief that investing in great businesses at attractive valuations will enable us to earn excess risk-adjusted returns for our shareholders over the long term. We do so by buying businesses with strong and durable competitive advantages, proven track records of successful capital allocation, high returns on invested capital, and free cash flow generation, a significant portion of which is regularly returned to shareholders in the form of dividends or share repurchases. We hope to maximize long-term returns without taking significant risks of permanent loss of capital. We are optimistic about the prospects of the companies in which we are invested while continuing to search for new ideas and opportunities.

Sincerely,

Alex Umansky
Portfolio Manager