Baron Durable Advantage Fund

Dear Baron Durable Advantage Fund Shareholder:

ALEX UMANSKY

PORTFOLIO MANAGER

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

Performance

We had a very good year.

Baron Durable Advantage Fund (the "Fund") gained 11.1% (Institutional Shares) in the fourth quarter, in line with the S&P 500 Index's (the "Index" or "Benchmark") return of 11.0%. The Fund finished 2021 with an impressive gain of 32.2%, outperforming the Benchmark's return of 28.7% by 345 basis points (3.5%).

Since its inception four years ago, the Fund generated an annualized return of 20.1% net of fees and expenses, which compares favorably to an annualized return of 17.7% (including dividends) for the Index.

Table I.
Performance
Annualized for periods ended December 31, 2021

	Baron Durable Advantage Fund Retail Shares[1,2]	Baron Durable Advantage Fund Institutional Shares[1,2]	S&P 500 Index[1]
Three Months[3]	10.99%	11.06%	11.03%
One Year	31.79%	32.16%	28.71%
Three Years	30.62%	30.93%	26.07%
Since Inception (December 29, 2017)	19.83%	20.11%	17.65%

U.S. large cap was unquestionably the place to be in 2021. Neither Omicron, nor elevated inflation could stop the S&P 500 Index from taking the crown in the second year of the pandemic. Even the late-year collapse of technology stocks, by far the largest sector in the Index, did not prevent it from posting a rather amazing 28.7% gain. Small and mid-cap growth stocks were up between low single and low double digits, while international developed markets were up around 12%. Emerging markets were actually down between low- and mid-single-digit percentage points. With all the talk and hype about inflation no longer being transitory, gold lost 3.5% making it unclear if gold still has a role to play as a hedge against inflation. Meanwhile, "digital gold," aka Bitcoin, had one of its usual crazy rides, peaking at around $69,000 per bitcoin and then coming down to $46,000 to finish the year with an impressive 60% return.

Through the lens of the Fund, the fourth quarter was uneventful and almost boring compared to the action taking place around it. We admit that's how we like it and to a large degree, that's exactly the point! The Fund missed out on last year's melt-up drama that swept up pockets of the market but still managed to beat the Index by 192bps. So, we fittingly avoided the melt-down of those same pockets this year and managed to do even better. Stock selection added 110bps to relative returns, while negative allocation effect took away 32bps. There is little else we have to say about the quarter other than our discussion of contributors, detractors, buys, and sells in sections of this letter that follow. As is our custom for the last quarter of every year, we will detail performance attribution from a trailing 12-month view.

Stock selection was responsible for the majority of our outperformance in 2021, as is typically the case in good times and bad, accounting for 307bps of excess returns. It was particularly strong in Health Care and Communication Services, while also contributing positively in Consumer Staples and Industrials. Stock selection detracted in Information Technology (IT) (where we did not own NVIDIA and owned too much of **Mastercard** and **Visa**) as well as Real Estate and Financials. From a sector allocation perspective, overweights in IT, Financials, and Communication Services and an underweight in Consumer Discretionary helped, while not investing in any Energy stocks was the biggest headwind.

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, 2021 was 1.91% and 1.48%, 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, 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.

1 The **S&P 500 Index** measures the performance of 500 widely held large cap U.S. companies. 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; one cannot invest directly into an index..

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.

Looking under the hood at the performance of individual stocks, we had many investments with strong contributions to absolute returns, as one would expect in a year like this. Fourteen of our holdings contributed over 100bps each, eight of which contributed over 150bps, while **Alphabet** and **Microsoft**, our top two performers, contributed over 400bps each. Eighteen of our holdings saw their stock price rise at least 30% each, while 14 of them were up 40% or more. In addition to Microsoft, shares of **Iqvia**, **Costco**, **Monolithic Power Systems**, and **Mettler-Toledo**, gained over 50%, while **Accenture** joined Alphabet and **Intuit** as our third investment with a gain of over 60%. As impressive as this was, we believe the real reason we outperformed in 2021 was because we only had four stocks down on the year, with the worst performer **Fair Isaac** (one of our top contributors in 2020) costing us just 26bps.

In the last two years we witnessed one of the more compressed as well as one of the more volatile market cycles in recent history. Over a period of less than five weeks from February 19 to March 23 of 2020, the S&P 500 Index lost a remarkable 33.8%. It took almost six months (or *just* six months, depending on your perspective) for the Index to fully recover. That recovery has continued uninterrupted with the Index gaining a remarkable 119.0% in a span of 21 months by the end of 2021. The Fund has performed well in this condensed market cycle, outperforming by a little bit on the way down and by a little more, on the way up.

This year it felt for the most part as if the market was heading only in one direction with all segments of the market up solidly in double digits. However, there were some obvious changes building underneath. We noticed it earlier in the year and it unmistakably accelerated in the last six weeks of 2021. As inflation has proven to be more durable than the Federal Reserve (and more importantly, market participants) initially expected, interest rates started rising again and discussion of Fed tapering was brought front and center again. This led to a sharp sell-off in fast-growth, higher-multiple, longer-duration stocks. Naturally, this environment is also driving renewed discussions over the merits of and allocations between “growth” and “value,” and in this context, we thought it would be beneficial to remind investors of the Fund’s philosophy and process.

An overwhelming majority of the “core” funds that we examined seem to take a blended approach of two extremes – a blend of fast-growing, high-multiple stocks and cheap (lower-quality, in our view) “value” stocks. We focus solely on the middle – investing only in what we believe to be the highest quality businesses with a proven ability to compound intrinsic value over long periods of time. Typically, these businesses are leaders in their respective industries and earn high returns on invested capital but are no longer able to reinvest all of the excess cashflows back into their businesses at high rates of return and hence, return it back to shareholders in the form of dividends or share buybacks. This approach enables us to collect multi-year compounders and aligns much better with our long-term ownership mindset. Conventional “value” investing, as we understand it, requires relatively constant churning of ideas since stock prices change and companies move from “undervalued” to “fair” or “overvalued,” especially in a highly volatile environment. We believe there are several distinct advantages to our approach:

- *Time arbitrage*. Buy and hold, which definitionally can only be applied to high-quality businesses, puts time on your side and makes it essentially work for you. All else being equal, there are usually good reasons why stocks trade at low multiples and are generally viewed as value stocks. Whether they are fallen-angels, turnarounds, restructurings, in need of a fresh product cycle or new management, almost invariably, they are low- or lower-quality businesses. While the prospects for eventual recovery vary from company to company, the time-horizon required for it to happen is structurally shorter. The intrinsic value of growing, high-quality businesses increases with time, while the intrinsic value of non-growing, lower-quality businesses actually deteriorates making it analogous to a melting ice cube and putting investors into a position of actually fighting against time! Even if, or when, a skilled value investor prevails and the business transforms itself, and the stock price and its multiple recover, the investment then must be sold, replaced with a new uncertain one, fighting against time. This process must then be repeated countless times. That’s a lot of difficult decisions. We want time on our side.
- *Guarding against and avoiding overdiversification*. We believe that overdiversification has been alpha destructive for a long time, especially in U.S. large cap. This is clearly one of the most efficient asset classes in the world and finding many businesses that are mispriced by the market on both sides of the value and quality spectrum is exceedingly difficult. By focusing exclusively on well-run, competitively advantaged businesses trading at attractive/reasonable multiples, we are more likely to avoid diluting our returns by not investing in lower-quality companies.
- *Risk management*. While many investors think of and define risk as volatility (beta, standard deviation, tracking error, etc.), we think of it in the context of permanent loss of capital and define it as *probability* of incurring such a loss. We believe our philosophy and process, when executed properly, should yield a portfolio with a structurally lower risk of permanent loss of capital because it is focused *exclusively* on businesses with wide competitive moats, proven management teams, pricing power, and market leadership that we expect will protect them against disruptive change.

In the context of the current market environment, we think it is worth pointing out that the Fund is a strategy focused on companies that are in the later stages of their growth lifecycles. As a result, we believe this to be a lower-risk and likely lower-return offering than our other strategies that are focused on faster-growing businesses. Still, it is not designed to manage market volatility. On the margin, we do expect less volatility in this Fund because we focus on singles and doubles as opposed to home runs and strike outs. But even more importantly in our view, we expect the probability of permanent loss of capital to be low and, as a result, our opportunity to generate alpha over full market cycles to be high.

Table II.

Top contributors to performance for the quarter ended December 31, 2021

	Quarter End Market Cap (billions)	Percent Impact
Microsoft Corporation	$2,525.1	1.75%
UnitedHealth Group Incorporated	472.9	1.18
Accenture plc	273.3	0.94
Alphabet Inc.	1,921.8	0.68
Intuit Inc.	182.1	0.60

Shares of **Microsoft Corporation**, a cloud-software leader and provider of software productivity tools and infrastructure, rose 19.6% during the fourth quarter following a solid earnings report highlighted by strength across all key performance indicators – revenues were up 20% and non-GAAP EPS was up 23% year-over-year in constant currency. Microsoft also reported an acceleration in Commercial Cloud, with revenues up 34% year-over-year in constant currency with gross margins outperforming by 100bps. We believe Microsoft remains a durable and growing business as companies across all industries look to digitally transform, taking advantage of the continuously expanding solution set Microsoft has to offer.

UnitedHealth Group Incorporated is a leading diversified health and well-being company serving 134 million individuals in all 50 states and more than 125 countries. The company operates across four segments: United Healthcare, Optum Health, OptumInsight, and OptumRX. Shares rose 28.9% on solid third quarter results with revenue growth of 11% year-over-year and adjusted EPS growth of 29% year-over-year. Strong 2022 guidance, which calls for mid-teens earnings growth driven by the shift to value-based comprehensive care delivery, expanded health benefits, health technology and financial services offerings, and pharmacy services. We believe that UnitedHealth will continue to benefit from positive demographic, population health, and value-based reimbursement trends, driving durability of growth and solid returns over the long term.

Accenture plc provides consulting and technology services to corporate clients around the world. Shares increased 29.9% on robust client demand, with 30% bookings growth and 27% revenue growth in the most recent quarter. Revenues and earnings exceeded expectations, leading management to raise full-year guidance to 16% to 19% revenue growth and 17% to 20% EPS growth. We believe Accenture is well equipped to help its clients pursue digital transformations and will continue gaining share in a large global market.

Alphabet Inc. is the parent company of Google, the world's largest online search and advertising company. Shares of Alphabet were up 8.7% in the quarter given continued recovery in ad spending (with total net revenues up 41% year-over-year), strong growth in cloud revenues (over 45%), and improved cost controls (operating margins reached 32%). We maintain high conviction in Alphabet's merits as it continues to benefit from growth in mobile and online video advertising, which accrues to its core assets of search, YouTube, and the Google ad network. We are further encouraged by Alphabet's investments in AI, autonomous driving (Waymo), and life sciences (Verily, Calico).

Intuit Inc. is the leading provider of accounting and tax preparation software. Shares increased 19.3% during the fourth quarter after the company reported quarterly results that beat Street estimates, with 22% growth in the Small Business segment and record-high revenues from Credit Karma. The company also closed the acquisition of MailChimp, which expands the product offering with a customer engagement and marketing platform and is accretive to EPS. Management increased full-year guidance to reflect better organic growth and the contribution from MailChimp. We continue to own the stock due to Intuit's strong competitive position and numerous growth opportunities.

Table III.
Top detractors from performance for the quarter ended December 31, 2021

	Quarter End Market Cap (billions)	Percent Impact
Stevanato Group S.p.A	$ 6.6	–0.15%
Visa, Inc.	472.0	–0.12
Meta Platforms, Inc.	935.6	–0.08
Texas Instruments Incorporated	174.1	–0.04

Stevanato Group S.p.A. is a leading global provider of drug containment, drug delivery, and diagnostic solutions to the pharmaceutical, biotechnology, and life sciences industries. The stock declined 11.4% during the quarter because the company's third quarter results, while strong, did not meet the high expectations of investors who wanted a bigger "beat and raise" relative to Street estimates. We continue to believe the business can compound in the high single-digit to low double-digit range on the top line with EBITDA margin expansion to the high 20% range over time underpinned by a product mix shift towards higher-value, higher-priced, and higher-margin products such as EZ Fill, Alba, and Nexa.

Shares of global payment network **Visa, Inc.** declined 2.5% during the quarter despite reporting quarterly results that beat Street estimates, with 29% revenue growth and 44% EPS growth. Investors may have been underwhelmed by management's guidance for 2022 of mid-teens revenue growth, which we believe is appropriately conservative given the uncertainties of cross-border travel and the pace of economic recovery. Shares also likely suffered from the broader pullback in most payment stocks during the quarter. We continue to own the stock due to Visa's durable growth characteristics and strong competitive advantages.

Shares of **Meta Platforms, Inc.**, the parent company of Facebook, the world's largest social network, were down 0.9% during the fourth quarter due to the negative impact of Apple's privacy changes in iOS mobile devices, which made it more difficult for Facebook to measure the effectiveness of its advertising across its mobile apps. We believe this is a near-term issue as Facebook develops an alternative solution. Longer term, Facebook will continue benefiting from its leadership in mobile to provide global advertisers targeted marketing capabilities at scale, with substantial monetization opportunities ahead from its core business, with additional optionality from its investments in e-commerce, WhatsApp, and Metaverse.

Shares of **Texas Instruments Incorporated**, the leading global analog semiconductor company, declined 1.2% during the quarter. The company continues to invest in expanding capacity for its semiconductor devices given strong demand for its products, which will impact earnings in the near term, but drive durable growth over the long term. Texas Instruments has a long history of investing ahead of growth and maximizing free cash flow over full market cycles to drive shareholder value. We remain investors as semiconductor content continues to increase across a broadening set of end markets and applications as well as Texas Instruments' strong competitive moats.

PORTFOLIO STRUCTURE

The portfolio is constructed on a bottom-up basis with the quality of ideas and conviction level (rather than benchmark composition and weights) determining the size of each individual investment. Sector weights tend to be an outcome of the stock selection process and are not meant to indicate a positive or a negative "view."

As of December 31, 2021, our top 10 positions represented 46.3% of the Fund, the top 20 were 77.3%, and we exited 2021 with 33 investments. IT and Health Care, our biggest sectors, represented 57.5% of the Fund. Financials, Communication Services, Consumer Staples, and Industrials represented another 39.8% of the Fund. Cash and Ecolab Inc., which is classified under Materials, were the remaining 2.7%.

The Fund's turnover in 2021 was 8.3% compared to the 11.9% average turnover ratio since inception.

Table IV.
Top 10 holdings as of December 31, 2021

	Quarter End Market Cap (billions)	Quarter End Investment Value (millions)	Percent of Net Assets
Microsoft Corporation	$2,525.1	$5.1	8.6%
Alphabet Inc.	1,921.8	3.7	6.2
UnitedHealth Group Incorporated	472.9	2.9	4.9
Arch Capital Group Ltd.	17.2	2.4	4.0
Danaher Corporation	235.1	2.4	4.0
Thermo Fisher Scientific Inc.	262.9	2.3	3.9
Accenture plc	273.3	2.3	3.9
Mastercard Incorporated	353.1	2.3	3.8
Meta Platforms, Inc.	935.6	2.1	3.5
IHS Markit Ltd.	53.0	2.1	3.5

Recent Activity

During the fourth quarter, we initiated one new investment, buying a small-sized position in **Nice**, a leading Contact-Center-as-a-Service ("CCaaS") software provider. We also took advantage of flows into the Fund, adding to 28 existing holdings. Lastly, we sold our **Alexandria Real Estate** and **Equinix** positions.

Table V.
Top net purchases for the quarter ended December 31, 2021

	Quarter End Market Cap (billions)	Amount Purchased (millions)
Arch Capital Group Ltd.	$ 17.2	$1.3
Mastercard Incorporated	353.1	0.8
TE Connectivity Ltd.	52.6	0.8
Thermo Fisher Scientific Inc.	262.9	0.7
Microsoft Corporation	2,525.1	0.7

During the quarter, we initiated a new position in **Nice Ltd.**, an enterprise software company with leading solutions that target two segments: Customer Engagement and Financial Crime and Compliance. Nice has more than 25,000 companies as customers, including 85 of the Fortune 100. The company executed an impressive digital transformation over the last several years from a set of legacy on premises-based offerings to a unified set of cloud-based offerings, with a single underlying tech stack, while accelerating the pace of innovation. Nice solidified its transition to a cloud company with the $1 billion 2016 acquisition of InContact, a leading CCaaS solution. They combined the InContact product with their Workforce Optimization offering, introducing an integrated solution less than a year later, dubbed CXOne. As a result, over the last five years Nice was able to grow its cloud business from around $300 million in revenues in 2016 to over $1 billion in 2021 (based on Street expectations), driving the stock price up nearly four-fold during the same period. While cloud already represents around 50% of total revenues, we believe we are not late to the story since we expect growth to remain durable with only around 15% of contact center agents across the industry having adopted the cloud thus far. As cloud grows in the mix, we believe that Nice will be able to accelerate overall revenue growth, while further improving unit economics (since cloud customers tend to have higher lifetime values).

During the quarter, we also took advantage of the inflows into the Fund to add to various existing positions. Our largest add was to **Arch Capital Group Ltd.**, the leading specialty insurance and reinsurance company. We made it a top five holding due to the company's great track record of underwriting discipline and capital allocation, while industry trends remain quite favorable. Our other adds included: **Mastercard Incorporated**, which should benefit from the rebound in cross-border travel and the longer-term shift away from cash; **TE Connectivity Ltd.**, a leading industrial company that should benefit from growing content in automobiles as fleets electrify and ADAS is adopted; **Thermo Fisher Scientific Inc.**, the leading life sciences tools company that would benefit from continued innovation in health care and favorable demographics; and the mega-cap software provider, **Microsoft Corporation**, since we believe it will continue benefiting from the digital transformation of entire industries and economies.

Table VI.
Top net sales for the quarter ended December 31, 2021

	Market Cap When Sold (billions)	Amount Sold (millions)
Alexandria Real Estate Equities, Inc.	$34.6	$0.4
Equinix, Inc.	72.4	0.3

As mentioned above, we decided to sell **Alexandria Real Estate Equities, Inc.** and **Equinix, Inc.** and reallocate to higher conviction ideas in which we saw a better risk-reward equation at current valuations.

Outlook

We believe that the future is inherently uncertain. Different sectors of the economy, different asset classes, and different investment styles go in and out of favor all the time. There is no one sector, asset class, or style that can reasonably be expected to be in favor or to outperform at all times. We think the investment philosophy and process of this Fund, which is rooted in the ownership of high-quality, well-managed, competitively advantaged businesses for the long term, when executed well, should enable us to come as close to the *all-weather portfolio* as possible.

This is NOT to suggest that it will be immune to volatility, market corrections, or even periods of underperformance. This is to suggest that we have high conviction that our process works and that it should enable us to generate attractive returns over full market cycles with a relatively low risk of permanent loss of capital.

As we write this letter, the market's immediate preoccupation appears to be with the well-communicated impending increase in the Fed Funds rate. Rising interest rates are generally a headwind to high-growth companies, which could be thought of as longer duration assets. And so, we continue to see a meaningful rotation out of software, fintech, and Health Care stocks into Energy, legacy Financials, and Industrials in early 2022. We tend to own more of the former and virtually none of the latter. We have no idea how long this rotation will last. While this could potentially become a headwind, current interest rates are so low (real interest rates are actually negative) that we expect the environment to remain accommodating for years to come. While we have neither the expertise nor a view on how transitory the current inflationary burst is, we believe that the types of businesses we hold in the Fund will perform just fine under most scenarios. If inflation persists, the inherent pricing power of our holdings will help them offset rising costs. Our investments are not highly levered and have stable growth profiles, so we also think higher interest rates should be less of a headwind for them. In any case, the market will do what it will do. We think rotations, pullbacks, and corrections are generally necessary and healthy, and they often create attractive opportunities for long-term investors like ourselves. We continue to focus on the quality of our decisions, and on taking what we believe are high percentage shots.

Every day, we live and invest in an uncertain world. Well-known conditions and widely anticipated events, such as Federal Reserve rate changes, ongoing trade disputes, government shutdowns, and the unpredictable behavior of important politicians the world over, are shrugged off by the financial markets one day and seem to drive them up or down the next. We often find it difficult to know why market participants do what they do over the short term. The constant challenges we face are real and serious, 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 are confident that our process is the right one, and we believe that it will enable us to make good investment decisions over time.

Our goal is to invest in large-cap companies with, in our view, strong and durable competitive advantages, proven track records of successful capital allocation, high returns on invested capital, and high free cash flow generation, a significant portion of which is regularly returned back to shareholders in the form of dividends or share repurchases. 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 are optimistic about the prospects of the companies in which we are invested and continue to search for new ideas and investment opportunities.

Sincerely,

Alex Umansky
Portfolio Manager

Investors should consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The prospectus and summary prospectus contain this and other information about the Funds. You may obtain them from its distributor, Baron Capital, Inc., by calling 1-800-99BARON or visiting www.BaronFunds.com. Please read them carefully before investing.

Risks: The Fund invests primarily in large cap equity securities which are subject to price fluctuations in the stock market. The Fund may not achieve its objectives. Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

The discussions of the companies herein are not intended as advice to any person regarding the advisability of investing in any particular security. The views expressed in this report reflect those of the respective portfolio managers only through the end of the period stated in this report. The portfolio manager's views are not intended as recommendations or investment advice to any person reading this report and are subject to change at any time based on market and other conditions and Baron has no obligation to update them.

This report does not constitute an offer to sell or a solicitation of any offer to buy securities of Baron Fifth Avenue Growth Fund by anyone in any jurisdiction where it would be unlawful under the laws of that jurisdiction to make such offer or solicitation.

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.