DEAR BARON DURABLE ADVANTAGE FUND SHAREHOLDER:

PERFORMANCE

Baron Durable Advantage Fund (the "Fund") gained 13.1% (Institutional Shares) during the second quarter, outperforming the 8.6% gain for the S&P 500 Index ("SPX"), the Fund's benchmark. The Fund is up 16.5% year-to-date, which compares favorably to the 15.3% return for the SPX.

Table I.
Performance
Annualized for periods ended June 30, 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]	13.11%	13.14%	8.55%
Six Months[3]	16.38%	16.53%	15.25%
One Year	36.31%	36.55%	40.79%
Three Years	20.87%	21.14%	18.67%
Since Inception (December 29, 2017)	18.67%	18.93%	16.67%

ALEX UMANSKY
PORTFOLIO MANAGER

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

Stocks continued moving higher during the second quarter, extending their rally over the last 15 months, with the SPX now up 96.1% cumulatively from the trough reached on March 23, 2020, and the Fund is keeping up with a similar return of 95.3%. Underneath the headline numbers however, the second quarter saw a reversal in some of the first quarter's trends with the yield on a 10-year U.S. Treasury bond declining from the highs of nearly 1.8% down into the 1.3% to 1.4% range. As a result, value stocks underperformed as investors were willing to look longer term, which benefited the types of businesses we tend to hold high-quality, long-term compounders. Having no exposure to various underperforming "reopening" areas such as banks, travel (hotels, airlines, cruise lines), or movie theater operators also helped.

Most of our outperformance in the quarter was due to stock selection, which was responsible for 378bps of the Fund's 461bps of outperformance. Most of that came from superior selection in the Communication Services, Health Care, and Financials sectors, with a more modest contribution in Industrials. Sector allocation contributed the remaining 82bps with overweights in Information Technology ("IT") and Communication Services and underweights in Utilities and Industrials contributing positively to relative results. The overall strength this quarter was broad based with positive relative contributions from all sectors except Materials and Energy, which cost us 9bps combined.

At the company-specific level, all our investments increased in value this quarter, except for **Ecolab**, which was down 3.5%. The majority (21 out of 36) were up double digits, including some of our largest purchases from last quarter. **Alphabet** was up 21%, **Facebook** up 18%, and **Microsoft** up 15%. Other big winners were some of the names that corrected the most in the first quarter, including **MSCI,** which was down 6% during the March quarter and up 27% in June, and **Adobe**, which was down 5% and then up 23%.

We have written in the past how we thought Poker and Fantasy Football could provide useful training ground for aspiring investors. Both are games of incomplete information that require patient and opportunistic capital allocation in the face of a wide range of outcomes, with the ability to manage the inherent uncertainty the future brings emerging as a critical skill set. From that perspective, Chess has little to offer us. Chess is a classic game of certainty. There is a "correct" move and a countermove at every step, where good decisions are rewarded and bad ones punished. There are no "ugly" river cards that radically change the texture of the board or catastrophic knee injuries that wreak havoc on your team's receiving corps, and the better player wins almost every game. Yet, there is a critical part of a Chess game that we think investors can learn from.

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, 2020 was 2.80% and 2.40%, 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, 2031, 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. The 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.

BARON FUNDS 1987

Baron Durable Advantage Fund

A game of Chess is divided into three distinct phases, known as the **Opening**, the **Middlegame**, and the **Endgame**, each with its own distinct strategies. The Opening typically covers the first 10 to 15 moves of the game in which both players are moving their pieces from their starting positions to take up active posts ready to do battle in the Middlegame. Advanced players usually have this stage of the game figured out where a decision to open with the Queen's Gambit or a Sicilian Defense is made before the game ever starts. This is akin to an investment team knowing/deciding how they will allocate funds on day one of a new fund. In both cases, it is not uncommon to stay up all night just before, agonizing over the final decisions of what you want to accomplish and what you need it to look like once the Opening is complete. The Endgame in Chess has been thoroughly analyzed and is rarely played out at a higher level since piece positioning makes it obvious who the winner will be. It has even less relevance to us since the investing we do has no Endgame. We do not optimize a portfolio to perform over any specific period of time (a quarter or a year). The investing we do is neither a sprint nor a marathon because there is no finish line. That brings us to the remaining phase of a Chess game that we think can be instructive to investors—the Middlegame!

According to Wikipedia "The *middlegame* in chess is the portion of the game in between the *opening* and the *endgame*. The middlegame begins when both players have completed the development of all or most of their pieces…. Theory on the middlegame is less developed than the opening or endgames. Since *middlegame positions are unique* from game to game, memorization of theoretical variations is not possible as it is in the opening. Likewise, there are usually too many pieces on the board for theoretical positions to be completely analyzed as can be done in the simpler endgames." The Middlegame is often considered the most exciting phase of the Chess game. It is in this stage of the game, after the Opening has finished but while there are still plenty of pieces on the board, that the outcome of the game is most frequently decided. One of the great challenges of the Middlegame is how to make progress when there are no obvious moves. We think of investing as the perpetual Middlegame. We go to great lengths to research, understand, and develop conviction in the companies in which we invest. More often than not, we are happy with our "Opening" and are comfortable with our "board." This is what Garry Kasparov, the greatest Chess player of all time, refers to as the "nothing to do" phase of the game. Interestingly enough, it is this stage of the game when action (as opposed to reaction) is required most! It is this ability to improve one's positioning through subtle, seemingly unimportant or insignificant moves that separates contenders from pretenders. Just like in Chess, we find there are frequent periods of time when there are no obvious buys or sells. Just like Mr. Kasparov, we believe that being proactive and not reactive is one of the keys to long-term success. We are always in the Middlegame and there are many "nothing to do" moments. So we proactively build a pipeline of ideas–great businesses that benefit from disruptive change with platform economics and network effects, run by talented entrepreneurs. Then we work on building the conviction, stress-testing our assumptions, analyzing the competitive landscape, comparing them to our existing investments–always asking ourselves where we could be wrong and then taking action when we feel the time is right. These shareholder letters are often focused on new ideas and we write about a few things that impacted the recent results the most. Often, the subtle, "seemingly unimportant" moves do not attract a lot of attention because they do not become apparent or impactful until some time in the future.

For example, Alphabet and Facebook were two of our largest additions in the fourth quarter of last year and then again in the first quarter of 2021 and both performed very well, up 42% and 27% year-to-date, respectively. Interestingly, this solid performance coincided with an accelerating news flow around Big Tech regulation. There are five new antitrust bills in the house targeting Big Tech, a G-7 proposal to change their tax rates (potentially taxing subsidiaries separately and limiting deductions), and a continued flow of litigation from the FTC, state attorney generals as well as international regulators. At the same time, Apple changed its privacy settings (App Tracking Transparency or ATT) such that users would need to proactively agree to share their data with the apps (and naturally, many decide not to; recent data points to only 10% to 20% of users agreeing to share their data). This in turn is reducing the quality of the signal that is used by advertisers and could create disruption in the advertising ecosystem.

So, have investors suddenly stopped caring about regulation? Is it priced in?

We think that over time investors realize that what really matters for the intrinsic values of both Alphabet and Facebook are the choices made by consumers on the one side and advertisers on the other side. As long as users continue going to Google to research their next vacation or the type of TV they want to buy, advertisers will choose Google as the place they want to spend dollars to reach those consumers. Similarly, as long as users keep spending around 30 minutes every day on each of Facebook and Instagram, advertisers will be there. The famous Facebook advertiser boycott lasted for one month… They just can't afford to not be there. Even the recent privacy changes brought by Apple, while potentially disruptive in the near term, could end up being a tailwind longer term to the walled gardens (Facebook, Alphabet and Amazon) due to the magnitude of first-party data these platforms have and the fact that they can increasingly close loops on the platform (shopping), which increases their relative value in the eyes of advertisers.

We wrote about Big Tech regulation in the past and our view remains largely unchanged:

"Big Tech's power comes from consumer adoption and consumer preferences and there is little to nothing that regulations can do about that. It's simply too late. Instead of trying to figure out how to break them up (we wrote in the past that we believe in every relevant case 1+1 will likely yield a value greater than 2), the regulators need to realize that these four Tech giants fighting each other is probably the best remedy (and a system of checks and balances) available to them today."

Baron Durable Advantage Fund generated an upside capture of 98.3% and a downside capture of 86.0% since inception. We believe it is our ability to excel in the Middlegame and take advantage of these "nothing to do" moments that has been the key to that success.

Table II.
Top contributors to performance for the quarter ended June 30, 2021

	Quarter End Market Cap (billions)	Percent Impact
Alphabet Inc.	$1,658.8	1.78%
Microsoft Corporation	2,040.3	1.21
Facebook, Inc.	985.9	1.11
Adobe Inc.	279.9	0.88
Moody's Corporation	67.8	0.79

Alphabet Inc. is the parent company of Google, the world's largest search and online advertising company. Shares of Alphabet were up 21% in the quarter driven by a continued recovery in ad spend, strong cloud revenue growth (up 46% in the first quarter year-over-year), and improved cost controls (with operating margins reaching 30% in the first quarter). We remain excited about 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).

Shares of **Microsoft Corporation**, a provider of software productivity tools and cloud infrastructure, rose 15% during the quarter following a strong earnings report highlighting solid demand for its broad product stack and continued momentum in cloud adoption. March quarter revenues were up 16% year-over-year (in constant currency terms), operating profits up 27%, EPS was up 34%, and Azure was up 46%. We believe Microsoft will continue enjoying durable growth characteristics as more companies look to digitally transform. Satya Nadella, Microsoft's CEO commented on these accelerating trends during the last earnings call:

"Over a year into the pandemic, digital adoption curves aren't slowing down. In fact, they're accelerating, and it's just the beginning. Digital technology will be the foundation for resilience and growth over the next decade. We are innovating and building the cloud stack to accelerate the digital capability of every organization on the planet."

We also believe that Microsoft's competitive advantages are strong and durable as it benefits from the long reach of its sales channel, its broad product set, its differentiated hybrid cloud offering, and its large installed base of enterprise customers. It therefore remains our second largest position in the Fund.

Shares of **Facebook, Inc.**, the world's largest social network, were up 18% this quarter on results that came in ahead of market forecasts with 44% revenue growth (in constant currency), which compared to Street expectations of 31%, driven by the recovery in ad spend. In our view, Facebook continues to utilize its leadership in mobile to provide global advertisers targeted marketing capabilities at scale, with substantial future monetization opportunities across its various assets including WhatsApp, Instagram, video tools including Watch and IG TV, and community-based marketplace, shopping, jobs, and dating features.

Shares of **Adobe Inc.**, the leading provider of content creation, document management, and marketing software, rose 23% following strong first quarter results and robust guidance ahead of consensus, with revenues up 23% year-over-year and operating margins hitting nearly 46%. We continue to believe the company is extremely well positioned over the long term given its marquee brand and best-in-class technology, which helps content creators and marketing professionals better reach, communicate, and sell their companies' products in an increasingly digitally connected world.

Moody's Corporation provides credit ratings, financial intelligence, and analytical tools to assist businesses in making decisions. Shares increased 22% in the quarter as bond issuance activity exceeded consensus expectations. Strong first quarter results were highlighted by 30% revenue growth in the ratings segment driven by an improving economic outlook and higher M&A activity. Favorable issuance trends continued into the second quarter with strong growth in high yield and leveraged loan issuance. We remain shareholders 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 also operates in attractive oligopoly markets where it enjoys meaningful competitive advantages and pricing power.

Table III.
Top detractors from performance for the quarter ended June 30, 2021

	Quarter End Market Cap (billions)	Percent Impact
Ecolab Inc.	$ 58.9	–0.03%
Alibaba Group Holding Limited	614.8	–0.01

Shares of **Ecolab Inc.**, a global leader in water, hygiene, and infection prevention, declined 4% in the quarter as the company continues facing COVID-related headwinds in its industrial and hospitality businesses along with the negative impact of rising commodity prices on margins. Note that while some near-term headwinds remain, trends are improving as economies reopen. We continue to believe 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. We think that the company has a substantial opportunity to grow organically, with only a 10% share of its estimated $13 billion addressable market.

Our new position, **Alibaba Group Holding Limited**, the largest retailer and e-commerce company in China, detracted 1bp from performance in the quarter (as its stock was flat in a rising market for the period held). Alibaba operates shopping platforms Taobao and Tmall and owns 33% of Ant Group, which operates Alipay, China's largest third-party online payment provider. Despite news that Chinese regulators had launched an investigation into the company for suspected monopolistic behavior and concerns of increased competition from peers, we believe the stock was flat because much of these risks were already priced in. We believe the risk-reward remains favorable for long-term investors, such as ourselves and hence decided to initiate a position.

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."

As of June 30, 2021, our top 10 positions represented 49.2% of the Fund, the top 20 were 74.6%, and we exited the quarter with 36 investments. IT, our largest sector, represented 35.2% of the Fund. Communication Services, Health Care, and Financials were 16.1% each (48.3% together), while Consumer Staples, Industrials, Real Estate, and Consumer Discretionary represented another 12.6% of the Fund. Cash and our Ecolab investment, which is classified under Materials, were the remaining 3.9%.

Table IV.
Top 10 holdings as of June 30, 2021

	Quarter End Market Cap (billions)	Quarter End Investment Value (millions)	Percent of Net Assets
Alphabet Inc.	$1,658.8	$2.4	8.2%
Microsoft Corporation	2,040.3	2.2	7.6
Facebook, Inc.	985.9	1.9	6.7
Visa, Inc.	515.7	1.3	4.5
Danaher Corporation	191.4	1.3	4.5
Adobe Inc.	279.9	1.2	4.3
Mastercard Incorporated	361.8	1.1	3.9
Moody's Corporation	67.8	1.1	3.7
Intuit Inc.	133.9	0.8	2.9
Thermo Fisher Scientific Inc.	198.3	0.8	2.9

Recent Activity

During the second quarter, we added two new holdings. The first is **Monolithic Power Systems**, a fabless (asset-light) analog semiconductor company; the second is **Alibaba**, the leading Chinese e-commerce platform. We took advantage of flows into the Fund to add to 25 existing holdings. We had no sales in the quarter.

Table V.
Top net purchases for the quarter ended June 30, 2021

	Quarter End Market Cap (billions)	Amount Purchased (thousands)
Monolithic Power Systems, Inc.	$ 17.1	$392.7
Alibaba Group Holding Limited	614.8	357.2
Intuit Inc.	133.9	332.6
Danaher Corporation	191.4	323.4
Visa, Inc.	515.7	255.6

Our largest purchase in the quarter was **Monolithic Power Systems, Inc.** ("MPS"), a best-in-class high-performance analog-power, fabless, semiconductor company. Over 95% of MPS's sales are DC-DC products which are used to convert and control voltages in a broad range of electronic systems across five key end markets including: Computing/Storage, Automotive, Industrial, Communications, and Consumer. The company's core differentiation comes from deep system-level and applications knowledge, strong design experience, an agile and entrepreneurial product-driven culture, and innovative proprietary process technologies. This differentiation enables MPS to provide highly integrated, energy efficient, cost effective, and easy to use monolithic (on one die) products.

Over the last five years, MPS has grown revenues at a 20% CAGR but, with approximately $1 billion in total annual sales, has less than 2% of the overall analog semiconductor market. Given its relative size in the market, we believe growth drivers will remain weighted towards design wins and company-specific factors rather than the overall macroeconomic environment, making MPS less cyclical than the broader semiconductor industry. While the company's legacy is in consumer products, which tend to be lower margin, it is rapidly expanding into other higher-margin end markets such as 5G infrastructure and devices, automotive ADAS, infotainment, electric vehicles, data center power supply and cooling, and sensor applications related to internet-of-things and industry 4.0. Those end markets require higher power efficiency with smaller form factors directly playing into MPS's strengths. As a result, over the last decade, MPS's exposure to consumer end markets declined from 65% of sales in 2010 to 26% in 2020. Even with solid and durable growth profile, the company has been returning 50% of free cash flow to shareholders in the form of dividends and buybacks. We believe MPS will be able to sustain its growth as it further penetrates new and growing end markets, while continuing to take share from competitors and returning excess cash to shareholders over time.

We also initiated a small position in **Alibaba Group Holding Limited,** the largest retailer and e-commerce company in China. Alibaba operates the shopping platforms Taobao and Tmall and owns 33% of Ant Group, which operates Alipay, China's largest third-party online payment provider.

We bought Alibaba shares taking advantage of the nearly 30% decline in its stock since October 2020, driven by the increased regulatory scrutiny of tech platforms in China. On the one hand, it is clear that regulatory risks are higher today than they have been in the past, and so we demand higher hurdle rates (or margin of safety) especially for investing outside the U.S., which is not the bread and butter of this strategy. On the other hand, we believe Alibaba's stock, at this valuation, represents a favorable risk-reward equation. In our view, Alibaba is one of the most undervalued platform businesses in the world. Its core business is highly profitable, while true earnings are masked by a host of earlier stage (and rapidly growing) businesses such as Ali cloud (Alibaba's "AWS"), Lazada (its marketplace business in Southeast Asia), Cianiao (its logistics business), and New Retail. It also enjoys strong competitive advantages, with over 1 billion annual active customers, and a 22% market share of total retail sales in China. Amazon, for example, has 8%. Despite that, as of the end of the second quarter, Alibaba was trading at less than 20 times fully diluted GAAP earnings, which were negatively impacted by all those early-stage businesses.

Table VI.
Top net sales for the quarter ended June 30, 2021

	Market Cap When Sold (billions)	Amount Sold (thousands)
No Sales		

Outlook

In the last quarterly letter, we wrote about not being too concerned with the "reopening" trade, even though it has benefited businesses we tend to shy away from (such as airlines, hotels and banks), and therefore had a negative impact on our quarterly returns. We did suggest that paying attention to the yield of the 10-year U.S. Treasury bond, which peaked at almost 1.8% during that time was important, as higher interest rates (specifically, significantly higher interest rates) would likely present headwind for equities even though our holdings tend to be more mature and hence, less susceptible to interest rate movements. We also reiterated that we do not attempt to predict inflation or interest rates.

Well…the annualized inflation rate for May (the CPI Index) came in at 5%. This is the first-time inflation reached 5% since *2008*. Jerome Powell, the chairman of the Federal Reserve then reiterated that in his opinion this high inflation number is "transitory" and that the Fed will not start raising rates until 2023. Though the message was consistent with his prior statements, this time the market had a different reaction and the yield on the 10-year bond came down to almost 1.3%. Last time we checked; we are all "transitory."

The Fed believes that the inflation rate will likely come back down to 2% to 2.5% annual rate in the next few months, which would be considered benign for the U.S economy. The more interesting phenomenon from our perspective is that whether inflation is running at 5% or at 2.5% one is absolutely guaranteed to lose money (in real terms) by investing in a 10-year government bond yielding less than 1.5%!

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.

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Downside Capture measures how well a fund performs in time periods where the benchmark's returns are less than zero. **Upside Capture** explains how well a fund performs in time periods where the benchmark's returns are greater than zero.

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