DEAR BARON FIFTH AVENUE GROWTH FUND SHAREHOLDER:

PERFORMANCE

We had a brutal second half of the fourth quarter which led to a tough year.

Baron Fifth Avenue Growth Fund (the "Fund") gained 0.7% (Institutional Shares) during the fourth quarter, which compared negatively to a gain of 11.6% for the Russell 1000 Growth Index ("R1KG") and a gain of 11.0% for the S&P 500 Index ("SPX"), the Fund's benchmarks. For the year, the Fund was up 11.2% compared to returns of 27.6% and 28.7% for the Fund's benchmarks, respectively.

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

	Baron Fifth Avenue Growth Fund Retail Shares[1,2]	Baron Fifth Avenue Growth Fund Institutional Shares[1,2,3]	Russell 1000 Growth Index[1]	S&P 500 Index[1]
Three Months[4]	0.64%	0.71%	11.64%	11.03%
One Year	10.92%	11.22%	27.60%	28.71%
Three Years	30.75%	31.07%	34.08%	26.07%
Five Years	26.02%	26.34%	25.32%	18.47%
Ten Years	19.33%	19.64%	19.79%	16.55%
Fifteen Years	11.81%	12.05%	13.72%	10.66%
Since Inception (April 30, 2004)	11.64%	11.84%	12.83%	10.83%

ALEX UMANSKY

PORTFOLIO MANAGER

Retail Shares: BFTHX
Institutional Shares: BFTIX
R6 Shares: BFTUX

Needless to say, we are disappointed with this result. Even after last year's strong 50.8% gain (over 12% and 32% better than the Fund's benchmarks, respectively), we expected a better relative outcome for 2021. The favorable investing environment that we have been pointing to as a meaningful tailwind was not there in the last 12 months, so some reversion to the mean and a period of consolidation was likely. Despite the pockets of the portfolio where valuations were clearly stretched, we generally felt good about the quality of the businesses, their improving fundamentals, and importantly, our position sizing. At the end of business on November 16, the Fund had a 27.9% year-to-date gain, which compared to the 27.7% and 26.7% gains for the Fund's benchmarks, respectively, and we have to admit we felt pretty good about the world and our place in it. Yes, a new COVID-19 variant called Omicron was discovered two days earlier in South Africa, and inflation was still running hot (we made fun of "transitory"), and we were putting fresh money to work at prices that we had wished were lower, but all in all…we thought we were in a good place.

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 1.02% and 0.75%, but the net annual expense ratio was 1.00% and 0.75% (net of the Adviser's fee waivers, restated to reflect current fee waivers). 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.

† The Fund's 4Q 2021 and 1-year historical performance was impacted by gains from IPOs and there is no guarantee that these results can be repeated or that the Fund's level of participation in IPOs will be the same in the future.

1 The **Russell 1000® Growth Index** measures the performance of large-sized U.S. companies that are classified as growth and the **S&P 500 Index** of 500 widely held large cap U.S. companies. Russell Investment Group is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell is a trademark of Russell Investment Group. The indexes and the Fund include reinvestment of dividends, net of withholding taxes, which positively impact the performance results. The indexes are unmanaged. Index performance is not Fund performance; one cannot invest directly into an index.

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 Performance for the Institutional Shares prior to May 29, 2009 is based on the performance of the Retail Shares, which have a distribution fee. The Institutional Shares do not have a distribution fee. If the annual returns for the Institutional Shares prior to May 29, 2009 did not reflect this fee, the returns would be higher.

4 Not annualized.

Some quarters ago, we wrote in this letter how "the best investors we know do not measure success in percentage gains, or dollars and cents… they measure success in *lessons learned*." Here is one to add to the list: this occupation will humble you! It is also more likely to happen exactly at a time when you believe you have things figured out. While below we offer reasons and explanations (some even good ones) for what has occurred, hubris and lack of necessary humility on our part clearly played a role in this disappointing outcome. Given the particular circumstances and market dynamics, the relative success we experienced over the prior four years was plainly not in the cards, but we made a number of mistakes that led to bad outcomes, and we all paid a price for it in the end. The good news is that most of these mistakes were related to timing, and we do not believe they caused us to suffer permanent losses of capital. Perhaps the better news is that a valuable lesson has been learned.

While we can attribute the entire underperformance of 2021 to the powerful rotation out of growth stocks that saw the Fund decline 13.0% over approximately the last 6 weeks of the year (from November 16), against the Fund's benchmarks that returned -0.1% and +1.6%, respectively, we will examine performance attribution from the trailing 12 months perspective as we have done in the last quarter of every year.

As is usually the case (in good times and bad), stock selection was responsible for the overwhelming majority (88%) of our underperformance for the year. Almost 80% of that can be attributed to Information Technology (IT), by far the largest GICS sector in the Fund's benchmarks and our best performing sector a year earlier. Stock selection also lagged in Health Care, Consumer Discretionary, Real Estate, and Industrials, while it was modestly positive in Communication Services and Financials. At over 58% of the Fund's average assets, IT and Health Care were our two best sectors in 2020 in terms of generating excess relative returns with 76% and 40% gains, respectively. In 2021, our investments in these sectors generated gains of just 7% and 10%, trailing far behind the benchmark returns of 33% and 24%, respectively.

Within IT, we were overweight several of the worst performing sub-industries, including internet services & infrastructure, which was down 33%; data processing & outsourced services, down 5%; and application software, which was up only 7%; so, in addition to poor stock selection in IT, we were also hurt by being in the wrong sub-industries. We had a similar experience in Health Care, our second worst performing sector for the year.

Looking under the hood at the performance of individual stocks, we had both a large number of winners as well as losers. On the positive side, 13 investments contributed at least 50bps each to absolute returns with **Alphabet**, **EPAM Systems**, **NVIDIA**, **ASML**, **Rivian Automotive**, and **Meta Platforms** (formerly known as Facebook) contributing over 100bps each. We owned 21 stocks that posted double-digit percentage gains in 2021, 8 of which were up 40% or more, with Alphabet and ASML posting gains over 60%, **Datadog** and EPAM had gains of at least 80%, and Rivian and NVIDIA more than doubled in price. So, the problem obviously was not with the lack of winners. To a large degree owing to the carnage of the last six weeks of the year, we ended up with an unusually large number of losers.

All in all, we had 18 stocks detracting from performance, 7 of which cost us over 50bps each, 1 of which – **RingCentral** – cost us over 100bps. Fourteen of those detractors recorded double-digit percentage losses, and there was simply no way to overcome that in a year in which the R1KG was up nearly 28%. Perhaps not surprisingly, many of these detractors were some of our largest *contributors* last year and we are confident that we did not suffer permanent losses of capital despite their stocks' precipitous decline in the latter half of the fourth quarter. Unfortunately, that cannot be said for all of them. **Alibaba** and **GDS Holdings**, our two investments in China, became impaired due to the uncertainty surrounding the changes in the regulatory regime, while a biotechnology holding **BridgeBio Pharma** suffered from a failed clinical trial. In all three of these instances, we thought we managed both the position sizing and the timing of the sales well enough to limit the damage and to avoid big chunks of the eventual declines, with Alibaba, the worst of the three, costing us 50bps.

From a 30,000 feet view, there were a number of factors that contributed to the disappointing results:

- Reversion to the mean – Over the short term, return profiles tend to be negatively correlated to most recent outcomes. When the market (or a segment of the market) is rising, our prospective return profiles are declining. When the market is in a drawdown, our expected return profiles rise. While in 2020, many of our holdings benefited from the rapid acceleration in digitization, they faced tougher comps in 2021, which drove a normalization in their growth rates, leading to a decline in the multiples investors assign to them. As we discussed in prior letters though, we do not believe the pandemic has just pulled forward spending, but that it has increased the size of the pie as well, which is more impactful for intrinsic values.

- Negative stock specific outcomes have cost us permanent loss of capital. This was due to a combination of mistakes made by us in analysis as well as due to bad outcomes materializing, despite considering them in our probabilistic decision making. Still, we erred by not assigning high enough weights for the bad scenarios to materialize. While we focus on minimizing this risk, in this business, mistakes are unavoidable. Our risk management process proved largely effective in 2021, enabling us to limit permanent losses of capital, which occurred in smaller-sized investments and did not have a material impact on overall results.

- Our timing on both sides of the ledger was bad, at least when examined over the trailing 12 months timeline. There is a fine line between being deliberate and diligent and being slow and indecisive. Of course, often our actions are characterized as one or the other based on the outcome, that is, we are diligent and deliberate when the outcome is good and slow and indecisive when it is not. In any case, we exhibited poor timing scaling into our Sea, PayPal, Block (formerly known as Square), and NVIDIA purchases. Note that while purchase timing is important in the near term, what tends to win over the long term is the quality of the underlying business and its duration of growth, such that if we are correct in our thesis, our poor timing will have limited implications when looked back in 5 and 10 years. Timing is inherently difficult to get right as it requires having a view on near-term trading dynamics (what the market or particular stocks would do over the near term). Sometimes we will get lucky and other times we won't. Over the long term, good and bad timing will cancel each other and have a limited impact on our long-term performance.

So, there is plenty of room for us to improve and we are going to continue to work hard to get better at our craft. We always suggested that investment results, or performance, should be evaluated over longer periods of time and ideally, over full-market cycles. The last 2 years saw one of the quickest full-market cycles we have experienced in our investing history, starting with massive 31.5% and 33.8% drawdowns for the R1KG and SPX, respectively, over the course of less than 5 weeks during the early days of COVID until hitting a trough on March 23, 2020, followed by an unprecedented recovery with the Indexes earning back all of their losses in less than 6 months. That recovery is still ongoing, with the Fund's benchmarks up a remarkable 136.0% and 119.0%, respectively, in a span of 21 months (to the end of 2021). The Fund has performed well for most of this condensed market cycle, outperforming in the first stage by 2.8% and 5.1% (from the peak on February 19 until the trough of March 23, 2020) vs. the Fund's benchmarks, respectively, and was ahead of the indexes in 2021 as well, until the middle of November when the tide turned against us, leading to our significant underperformance over the last 6 weeks of the quarter.

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

	Quarter End Market Cap (billions)	Percent Impact
Rivian Automotive, Inc.	$ 93.4	1.49%
NVIDIA Corporation	735.3	1.09
EPAM Systems, Inc.	37.9	0.72
Alphabet Inc.	1,921.8	0.56
Datadog, Inc.	55.6	0.33

We participated in the well-received November IPO of electric vehicle company **Rivian Automotive, Inc.**, adding to our pre-IPO position. Rivian is launching vehicle programs for both the consumer and commercial markets, enabled by its unique partnership with Amazon. While the launch of parallel programs is complex, it should allow scale and data collection advantages. With supplier and regulator support, its high-capacity factory, significant cash reserves, strong partnerships, and talent, we believe that Rivian will be a key participant in the growing electric automotive market. We go into more details on our thesis in the new buys section below, but this is a good example of the reasons behind following and occasionally participating in private investments. Thanks to the work we have done on Rivian over the last few years, we were able to build conviction and participate in size in the company's IPO.

NVIDIA Corporation is a fabless semiconductor company and a leader in gaming cards and accelerated computing chips. NVIDIA is powering the growth of artificial intelligence from the data center to the edge. Shares of NVIDIA rose 42.0% in the fourth quarter on financial results and guidance that were significantly above Street expectations, driven by continued strength across both its gaming and data-center segments, which in turn benefited from the upgrade cycle to RTX (ray-tracing technology) and the growing adoption of AI/ML applications from both hyperscalers and enterprise customers. NVIDIA's total third quarter revenues of $7.1 billion beat Street expectations by $282 million, growing 50% year-over-year, while fourth quarter revenue guidance was over $0.5 billion above expectations. Given its leading market share in gaming, data centers, and autonomous machines, the size of those markets and how early we are in the penetration of AI/big data, we believe NVIDIA can grow rapidly for years to come.

EPAM Systems, Inc. provides outsourced software development to business customers. Shares rose 17.5% on quarterly results that beat Street forecasts, showing continued acceleration with 52% revenue growth and 47% EPS growth. Full-year financial guidance was also raised to reflect strong client demand across all market segments. Management expects organic revenue growth to exceed 20% over the long term with upside from accretive acquisitions. EPAM operates at the forefront of digitization by helping customers optimize ways to interact with their clients, enabling them to become more engaging, responsive, and efficient. Following the slowdown in the early stages of the pandemic, investments in digital transformation have risen in priority. We remain excited about EPAM's long runway for growth underpinned by the need for digital transformations and the company's strong execution in addressing this growing demand. Despite years of strong double-digit growth, it still accounts for less than 3% of the $150 billion annually spent on digital engineering services.

Alphabet Inc. is the parent company of Google, the world's largest online search and advertising company. Shares of Alphabet were up 8.5% 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 have 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).

Datadog, Inc. is an infrastructure monitoring, application performance monitoring, and log management software platform. Shares appreciated 25.9% after Datadog reported strong financial results, with an acceleration in revenue growth to 75% year-over-year, leading to annualized recurring revenues passing $1 billion for the first time. Growth was driven by new customer wins (adding a remarkable 17,500 new customers in the last quarter), growing usage of existing products and the successful cross-selling of new products to existing customers. We have conviction in Datadog's growth durability due to the secular tailwinds of cloud computing, growing demand for application monitoring, and Datadog's expansion into new product categories such as application security.

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

	Quarter End Market Cap (billions)	Percent Impact
Block, Inc.	$ 74.5	–0.95%
PayPal Holdings, Inc.	221.6	–0.72
Sea Limited	124.1	–0.54
Twilio Inc.	47.0	–0.45
MercadoLibre, Inc.	68.0	–0.40

Block, Inc. provides point-of-sale technology to small businesses and operates the Cash App ecosystem of financial services for consumers. The stock declined 32.7% on quarterly results that missed Street forecasts. Cash App growth is moderating from elevated levels as the benefits of government stimulus payments wear off. Shares also may have suffered from investor concerns about the earnings prospects for the pending acquisition of Afterpay. We continue to own the stock due to, in our view, Block's long runway for growth, competitive advantages, and unique corporate culture as the company remains early in penetrating a $160 billion revenue opportunity.

PayPal Holdings, Inc. enables digital payments for consumers and merchants worldwide. Shares fell 28.1% on financial results that missed Street forecasts and reduced guidance due to the faster-than-expected roll-off of eBay's processing business and slowing e-commerce growth as stores reopen. Shares were also pressured by discussions of a potential acquisition of Pinterest as well as broader weakness across payment stocks during the quarter. With over 380 million active users and 33 million merchants on the platform worldwide, PayPal enjoys a dominant competitive position with a two-sided network effect that is multiples larger than the closest competitors. PayPal's ubiquity with consumers makes the company attractive to merchants, leading to over 80% penetration in the Top 500 internet retailers, and their ubiquity with merchants makes them attractive to consumers. Moreover, PayPal remains in the early stages of monetizing Venmo, while also broadening and deepening its financial offerings to consumers. With the acceleration of online penetration and PayPal's leading market position, we believe it has the opportunity to grow rapidly for years to come, hence we remain shareholders.

Shares of **Sea Limited**, a Singapore-based but increasingly global e-commerce platform, declined 30.5% in the fourth quarter due to multiple compression in global internet stocks along with rising losses in its e-commerce segment above market expectations as the company continues reinvesting back into its business (which we believe would benefit it over the long term). We are impressed by the way in which Sea overtook the incumbent e-commerce players across Southeast Asia despite a later start, in an industry where first mover advantages are important. While the runway for growth in its Southeast Asian market remains long, we also believe Sea has a good probability of success in penetrating new markets in Europe and Latin America.

Twilio Inc. is a leading Communications-Platform-as-a-Service company offering a set of application programming interfaces that help developers embed communications into their software. Shares declined 17.5% on the back of slower year-over-year organic growth as a result of a normalization in pandemic-driven use cases. We believe that despite working through tough comps due to the faster ramp in newer cohorts during the depth of the pandemic, organic growth should improve in 2022 as synergies from the Segment acquisition positively impact results. We believe Twilio is coming out of 2021 in a stronger position than it entered the year due to the Segment acquisition and the recent introduction of Twilio Engage, which makes Twilio a more strategic solution for customers, increases customer stickiness and priority in IT budgets, widens its competitive moat, and expands its addressable market. Longer term, we continue to believe that the accelerating pace of digitization will enable Twilio to grow at high rates for years to come.

Shares of **MercadoLibre, Inc.**, Latin America's leading e-commerce and digital payments platform, declined 19.7% in the quarter due to valuation compression in global internet stocks and concerns regarding Brazilian consumption as a result of high rates of inflation, difficult e-commerce comparisons, and reduced fiscal stimulus for consumers relative to last year. We remain shareholders as we believe the company is a long-term winner in both e-commerce and payments across a region that remains in the early stage of digitization. We also believe that MercadoLibre will continue benefiting from its strong competitive positioning, particularly given its substantial investments in logistics, distribution, and IT infrastructure along with the long-term focus of its management team.

Portfolio Structure

The Fund's portfolio is constructed on a bottom-up basis with the quality of ideas and conviction level determining the size of each 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." During times of volatility, while other market participants try to manage volatility by diversifying, we tend to concentrate the portfolio on our higher conviction ideas (since we don't equate volatility with risk as mentioned above). Accordingly, the weight of our top 10 and top 20 positions increased and represented 51.6% and 78.0% of the Fund, respectively, as of December 31, 2021 (these compare to weightings of 45.8% and 73.1%, respectively at the end of the third quarter and weightings of 43.0% and 71.3% at the end of 2020).

IT, Consumer Discretionary, Communication Services, Health Care, and Financials made up 98.1% of net assets. The remaining 1.9% was made up of GM Cruise and SpaceX, our two private investments classified in Industrials, and cash.

The Fund's turnover was 22.8% in 2021, compared to average turnover of 19.5% over the last three years, and 16.2% average turnover over the last five years.

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

	Quarter End Market Cap (billions)	Quarter End Investment Value (millions)	Percent of Net Assets
Amazon.com, Inc.	$1,691.0	$64.2	7.6%
Alphabet Inc.	1,921.8	63.0	7.5
Rivian Automotive, Inc.	93.4	59.0	7.0
ServiceNow, Inc.	129.2	41.7	4.9
EPAM Systems, Inc.	37.9	39.1	4.6
NVIDIA Corporation	735.3	36.7	4.3
Shopify Inc.	172.4	34.4	4.1
Intuitive Surgical, Inc.	128.4	33.8	4.0
Mastercard Incorporated	353.1	33.2	3.9
Adobe Inc.	269.8	31.0	3.7

Recent Activity

During the fourth quarter, we added to 14 existing positions including to electric vehicle manufacturer **Rivian Automotive**, in which we previously had a small investment. We continued building our more recent position in the leading Southeast Asian e-commerce platform, **Sea**, while also increasing our position in the leading commerce platform, **Shopify**, which is now a top 10 holding. We also took advantage of market volatility to add to our investment in **PayPal**. Finally, we liquidated four holdings – Visa, Acceleron Pharma, Equinix, and Zoom Video, exiting 2021 with 36 positions (note that our top 30 investments represented 95.8% of the Fund as of December 31, 2021).

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

	Quarter End Market Cap (billions)	Amount Purchased (millions)
Rivian Automotive, Inc.	$ 93.4	$38.3
PayPal Holdings, Inc.	221.6	9.9
Shopify Inc.	172.4	9.6
Sea Limited	124.1	9.6
GitLab Inc.	12.6	5.1

Our largest purchase in the quarter was **Rivian Automotive, Inc.** We expect that over the next decades, the automotive industry will shift from a combustion powertrain, human-driven, and unconnected fleet to an electrified, software-enabled, and connected industry. These are tectonic transitions that should meaningfully increase the size and profitability of the industry. Moreover, with battery and software as core competencies, leading EV automotive companies should be able to capture new and attractive growth opportunities including software services, autonomous delivery, energy storage, and more. With modern vehicle architecture, a software-first approach, and strong talent position, we believe that differentiated, well-managed, and newer automotive companies can capture a large portion of the value generated through this structural change.

In November, following years of engagement and investment in Rivian as a private company, an enlightening factory visit, and a deep product and strategy review, we participated in Rivian's IPO, one of the largest IPOs in recent history. Enabled by its unique partnership with Amazon and vehicle architecture, Rivian is launching multiple vehicle programs focused on both the consumer and commercial markets. While a parallel vehicle program launch may be complex, we expect it would allow the company to reach scale and collect data faster than many of its competitors, while also benefiting from vertical integration and economies of scale across both markets. Additionally, with management's focus on software enablement from the onset of the company, Rivian offers a broad set of value-added services to customers, allowing the company to generate more revenue while offering a better customer experience. With supplier and regulator support, its high-capacity factory, significant cash reserve, strong partnerships, and talent, we believe that Rivian can reach its target of multi-million vehicles across different geographies and industries over time.

During the fourth quarter, we participated in the IPO of **GitLab Inc.** GitLab provides a software development and IT operations ("DevOps") platform that developers, product managers, IT operations teams, and security professionals use to collaborate throughout the software development lifecycle. The GitLab platform helps developers plan, create, verify, test, and deploy code. Once code is shipped into production, IT operations professionals can use GitLab to continuously protect and monitor code and identify any issues or bugs for further updates. Together these products help more than 15,000 customers reduce time to market for new applications, automate continuous feature updates, reduce security vulnerabilities, and retain developer talent. GitLab is the only end-to-end DevOps platform that addresses all stages of the software lifecycle using a single codebase and unified data model, giving it a competitive advantage over point solutions. GitLab also employs an open-source model, which has led to viral adoption among 30 million developers. More than 2,600 of these developers are active contributors to GitLab's product, enabling the company to release upgrades much faster than competitors. We also like Gitlab's culture of innovation which is best described in its public handbook[1]:

"At GitLab, our value of iteration has a unique impact on the way we operate and get things done.

Working this way means our team members are expected to quickly deliver the minimum viable change in their work instead of waiting to produce a polished, completed product.

While this can be a challenging practice to adopt at first, it's liberating to be able to make mistakes, get feedback quickly, and course correct to reach a better outcome, faster."

These consistent product enhancements have led to low churn and strong expansion in GitLab's existing customer base, driving a best-in-class 130%-plus net retention rate. GitLab is in the early innings of monetizing its large active user base, and with only 0.5% penetration of the $43 billion application development software market, we see a long runway for growth ahead.

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

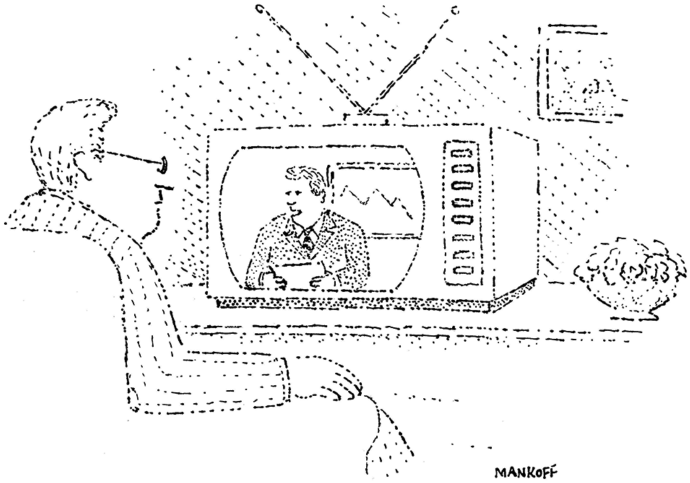
	Quarter End Market Cap or Market Cap When Sold (billions)	Amount Sold (millions)
Visa, Inc.	$454.6	$21.0
Acceleron Pharma Inc.	10.9	19.8
Equinix, Inc.	72.4	17.7
Meta Platforms, Inc.	935.6	10.0
Zoom Video Communications, Inc.	74.7	7.2

We sold our **Acceleron Pharma Inc.** position, a biotechnology company, during the quarter after the company was acquired by Merck. We also sold our **Visa, Inc.** and **Equinix, Inc.** positions and reduced our **Meta Platforms, Inc.** holding to allocate capital to investments that have a better risk/reward profile and which, in our assessment, are more likely to remain big ideas for longer. We also sold our small position in **Zoom Video Communications, Inc.**, a stock we bought in the second quarter, which proved to be a mistake as enterprise adoption trends slowed down further.

[1] https://about.gitlab.com/handbook/

Baron Fifth Avenue Growth Fund

Outlook



"On Wall Street today, news of lower interest rates sent the stock market up, but then the expectation that these rates would be inflationary sent the market down, until the realization that lower rates might stimulate the sluggish economy pushed the market up, before it ultimately went down on fears that an overheated economy would lead to a reimposition of higher interest rates."

CartoonStock.com

We have seen a significant shift in the investing environment over the last six weeks of 2021 and continuing into 2022 as investors began rotating out of growth companies and into shorter duration investments (which would be less impacted by tightening monetary policy) with interest rates moving up (the 10-year bond yield is now above 1.75%), even though real rates remain negative (10-year TIPS have an implied yield of around -0.70% presently).

It is especially during times like these, investors ask us to provide our outlook for the next 3, 6, and 12 months. While they are willing to let us get away with talking about and focusing their attention on long-term opportunities when they feel good about the world and they are generally in a "good place," it seems that during the times of drawdowns and stress, the fear and anxiety over short-term losses turning into sustained losses and permanent losses of capital overwhelms all other senses. Three years from now, let alone five, seems so far out, and if you're clueless about the next three to six months why should anyone listen to your views five years out?

Well… we are clueless about the next three to six months. Always were. But we have a long track record that suggests that our investment process works, and that it should enable us to generate excess risk-adjusted returns if we execute it well, over full-market cycles. We do not know when this rotation will end or how much more "pain" there is left to go, but we do know that it will end. There will come a time when investors' attention will refocus on the long term and the inherent unpredictability of short-term stock gyrations will come to matter less. That time always comes. That's when we hope and expect to be doing well again.

When we look forward over the next 5 to 10 years, we have high conviction that every company will need to digitally transform, adopt the cloud to accelerate their innovation feedback loops, make better sense of their data to know what customers want and how to reach them, and adopt artificial intelligence to achieve that. Similarly, we are living through unprecedented revolutions in health care, transportation, and commerce. Many of our holdings are the enablers of those disruptions and will become materially larger as those markets and technologies mature.

Also, it is important to remember that prospective (or future) market returns tend to be negatively correlated with present (or recent) returns. When the market is rising, our return profiles are declining. When there is a drawdown, the return profiles are rising. Said differently, the margin of safety between our stock prices and their intrinsic values has risen significantly over the last seven weeks. If we liked Shopify at $1,700 per share, then we are likely to be even more fond of it $1,100, assuming no significant change in its competitive dynamics. The prospective return from $1,100 is plainly more attractive than it was from $1,700 just seven weeks ago. We do not believe this price correction, while painful for all owners of the company, represents permanent loss of capital and view this as an attractive opportunity with much-improved risk-reward dynamics. We feel the same way about the majority of our investments.

Finally, it is important to understand that intrinsic values of the businesses we own typically increase every year, in many cases, materially so. The stock prices usually reflect those increases, at least directionally, although never quite at the same pace. At the end of 2020, we warned that while intrinsic values of the companies that comprised the Fund increased substantially, they did not match the Fund's 50.8% return. On the other hand, the increase in intrinsic values that surely occurred in 2021, was likely larger and not fully reflected in the Fund's 11.2% gain.

It is even more evident when examined at the company-specific level. For example, Twilio's stock declined 22.2% in 2021, while we believe that the company's intrinsic value expanded significantly. We expect year-over-year revenue growth to *exceed 60%*, driven by the closing of the Segment acquisition (a leading Customer Data Platform or CDP), and the introduction of Twilio Engage, a solution that expands Twilio's offering from the communication layer to an end-to-end customer engagement platform. This makes Twilio a more strategic solution for customers, increases customer stickiness, a priority in IT budgets, widens its competitive moat and expands its addressable market, which we believe will enable it to grow rapidly for longer. Similarly, while RingCentral's stock has corrected dramatically (down 50.6%), the company's *intrinsic value has increased* in our view. Despite growing investor concerns over competitive dynamics in the industry, RingCentral's annualized recurring revenues accelerated five points this year (on a larger base and tougher comps) from over 34% growth in the third quarter of 2020 to over 39% in the third quarter of 2021, driven by a growing contribution from the distribution deals it has signed with large incumbents over the last few years. RingCentral has also closed a new deal with Mitel, expanding the potential seat base for which it has a "first shot on goal" to over 200 million. In both of these examples, we believe that lower stock prices will not result in permanent losses of capital.

We think that rotations, corrections, and drawdowns are generally necessary and healthy, and in any case, are largely unavoidable. Almost always, they present good opportunities for long-term investors such as ourselves. We are taking advantage of this correction and adding to our highest conviction ideas, which are now trading at a greater margin of safety to their intrinsic values than they have in a while. 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.

Every day we live and invest in an uncertain world. Well-known conditions and widely anticipated events, such as Federal Reserve rate changes (up and down), 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 the 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 optimistic about the long-term prospects of the companies in which we are invested and continue to search for new ideas and investment opportunities while remaining patient and investing only when we believe the target companies are trading significantly below their intrinsic values.

Sincerely,

Alex Umansky
Portfolio Manager

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