



INVESTOR

Baron Fifth Avenue Growth Fund

Finding Long-Term Growth Opportunities in Large Cap Stocks

According to the conventional wisdom, large cap stocks are the place to go for value-oriented passive investing. These companies have already reached their growth potential, the thinking goes, and the efficiency and transparency of this asset category makes it tough for active managers to beat the benchmark.

We have never followed the conventional wisdom. On the contrary, we believe there are massive growth opportunities for the selective investor who eschews the conventional wisdom to analyze large caps with a fresh and unbiased eye.

2020 has proven to be the perfect illustration of the fallacy of the conventional wisdom. The meteoric rise in the U.S. market after the sharp decline in late March and April was driven in large part by five mega-cap companies: **Amazon.com, Inc. (AMZN)**, **Alphabet Inc. (GOOG)**, **Apple, Inc. (AAPL)**, **Microsoft Corp. (MSFT)**, and **Facebook, Inc. (FB)**. Together, these stocks accounted for 160% of the market's increase in 2020. Subtract them from the calculus and the rest of the market actually declined during this time.

So what's going on? The pandemic-driven changes to our lives – how we work, shop, socialize, travel (or not), learn, and even exercise or relax – have accelerated the rate of digitization and other disruptive secular trends. Companies that are agents or beneficiaries of these disruptive changes were poised to advance during and especially after the pandemic, expanding their competitive moats and accelerating growth in their intrinsic values. These companies are – and have always been – the focus of Baron Fifth Avenue Growth Fund.

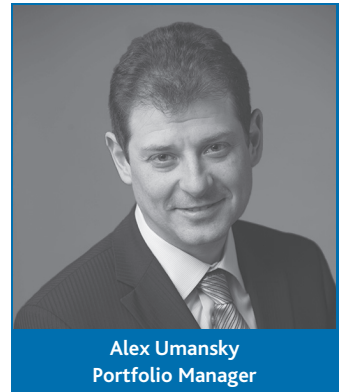
We also think our businesses stand to benefit in other ways from the changes brought on by the pandemic. We invest based on company fundamentals, seeking the best positioned, best capitalized, best managed businesses. These are the companies we think are most likely to survive or even thrive in challenging macro environments. Competitors that are poorly capitalized or managed tend to fall away. They cut their cost too deep, they forget about their customers or they just can't weather the storm. As Warren Buffett observed during the 2008-09 recession, "Only when the tide goes out do you discover who's been swimming naked." When conditions normalize, our companies should be even better situated to aggregate market share.

Performance listed in the above table is net of annual operating expenses. Annual expense ratio as of September 30, 2020 was 0.78%, but the net annual expense ratio was 0.75% (net of the Adviser's 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 reimbursed 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 3Q2021 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.

Baron Fifth Avenue Growth Fund

Baron Fifth Avenue Growth Fund is managed by Alex Umansky, who brings over 27 years of research and investment management experience to his position. The Fund is differentiated by its high conviction – 39 stocks as of September 30, 2021 – compared with its Morningstar peer group average of 102 stocks, low turnover of 15.87%, and long-term view of risk, return, and volatility.



Alex Umansky
Portfolio Manager

As seen below, this approach has produced outstanding results over the nearly 10 years since Alex took over management of the Fund on November 1, 2011, outperforming its benchmarks and its peers across every standard time period since that time.

Notably, the Fund has achieved these results with relatively low risk. For the five-year period ended September 30, 2021, it generated annualized alpha of 1.80% with beta of 0.99, up/down capture of 98.72% and 86.95%, respectively, and a Sharpe ratio of 1.31%.

Baron Fifth Avenue Growth Fund as of 9/30/21 (annualized)*

	1-year	3-year	5-year	10-year	Since inception**
Baron Fifth Avenue Growth Fund	19.44%	22.93%	24.52%	20.65%	11.98%
Russell 1000 Growth Index	27.32%	22.00%	22.84%	19.68%	12.31%
S&P 500 Index	30.00%	15.99%	16.90%	16.63%	10.33%
Morningstar Large Growth Category Average	26.60%	19.75%	20.68%	17.93%	N/A

* Institutional shares. For Retail and R6 shares, visit www.BaronFunds.com

** Inception was 4/30/2004

Disruptive Change

To find long-term, durable growth opportunities in the large cap space, we focus on disruptive change. We believe change is the only constant in the economy. We believe the key to successful growth investing, especially in the large cap space, is understanding whether a change is real, durable, and material, and identifying which companies will be disrupted and dislocated and which will grow stronger and bigger. Examples of disruptive change include:

- Digitization
- Cloud computing
- Machine learning
- Artificial intelligence
- Big data
- Autonomous driving
- Virtual reality
- Blockchain
- CRISPR

Taken together, these changes could loosely be grouped within what is popularly known as digital transformation. The Fund invests in Big Ideas – unique, competitively advantaged companies that are agents or beneficiaries of these changes. These are companies that are in it for the long term, investing in game changers that reach across multiple industries and are set to transform the world as we know it. They have visionary leaders that inspire and encourage a culture of constant innovation and improvement. They are unique.

A Truly Differentiated Approach

To identify the companies that we believe are engaged in disruptive change, we look for unique businesses we believe have open-ended growth potential, excellent management, and durable competitive advantages, at an attractive valuation. While this is the standard Baron investment strategy, we build out on these basic principles for a uniquely targeted approach for Baron Fifth Avenue Growth Fund.

Growth potential First, we must be convinced that the company can become materially larger, reaching what we call its endgame. To do so, we first determine the size of the market opportunity. Then we look at the company's current market share and estimate the share it will need to capture to meet our objective or endgame. We project cash flows based on different growth rates over different periods of time and calculate the projected EBIT. Then we bring our calculations back to present value. The process is akin to the one used to ascertain discounted cash flow, except the reverse.

In evaluating growth potential, we favor companies with:

- Secular, organic growth
- Free cash flow and higher or rising returns on invested capital
- Low capital intensity
- Positive optionality (hidden assets, unexpected/mispriced monetization opportunities)
- **Secular, organic growth** We prefer companies that grow organically over the long term. Organic growth is repeatable and we think more sustainable, whereas growth by acquisition is neither. In addition, acquisitions can carry higher risk, as many are bought at a premium and/or may have packaged themselves for sale by overearning while underinvesting in growth.
- **Free cash flow and higher or rising returns on invested capital (ROIC)** We run screens for free cash flow yield and ROIC as a source of investment ideas. We prefer free cash flow as a valuation measure

because unlike earnings, it cannot be manipulated. We also emphasize ROIC, as it demonstrates whether growth can be profitable and is the metric most correlated to future stock performance. Growth for the sake of growth is not sustainable.

- **Asset light, low capital intensity businesses** We like asset light, low capital intensity businesses because as they scale, margins can expand significantly. Companies such as **Amazon.com Inc. (AMZN)** and **Facebook, Inc., (FB)** (through its marketplace feature), which have built online platforms connecting third party vendors with customers, illustrate this concept. After the platform is built, the cost involved in adding new businesses or customers is de minimus, meaning that the incremental margins on these additions is exceptionally high.
- **Positive optionality** We have found that the market tends to undervalue or even ignore businesses, products, or services a company may have that are peripheral to its core business. For example, most of the analysts covering Alphabet focus on the advertising business generated by the Google search engine and YouTube video site, with little or no attention paid to the rest of Alphabet's portfolio, encompassing everything from internet-beaming hot air balloons to self-driving cars to Google Cloud. We are invested in Alphabet based on our thinking that the optionality offered by these other investments is enormous, and we do not have to pay much to own them.

Amazon serves as a good illustration of how we calculate growth potential. As of the time of this writing, the company is valued at \$1.664 trillion. It seems astonishing that Amazon can grow much larger at this stage, yet we project the company will double or triple in size because even with the pandemic e-commerce is still only about 20% penetrated in the U.S. In other words, 85% of all retail business in the U.S. is conducted through physical locations. Amazon's share of e-commerce is currently roughly 40%, far ahead of any of its e-commerce competitors. Yet it still has just 8% of its total addressable market, implying a massive runway for growth. Another one of its many businesses, Amazon Cloud, is the leading cloud vendor with about 32% market share. Yet the cloud represents just 40% of business workloads, with the remaining 60% divided between on-premises legacy and private/hybrid cloud computing. By our calculation, Amazon has a leadership position in eight trillion-dollar markets. With these numbers in mind, we can foresee an endgame that is two to three times Amazon's present value.

Company specific criteria In addition to the size of the potential market, we develop a company thesis for each of our investments. In particular, we seek companies with the following attributes:

- Uniqueness
- Durable competitive advantage
- Platform business
- Exceptional management
- Recurring revenue
- Pricing power
- **Uniqueness** The uniqueness of a company is determined by its culture, which is shaped by the values and vision of its leaders. Amazon founder and CEO Jeff Bezos' mantra is "every day is day 1." We think this vision is the force behind Amazon's 25-year story of

Baron Fifth Avenue Growth Fund
Top 10 Holdings as of September 30, 2021*

Holding	Sector	% of Net Assets
Amazon.com, Inc.	Consumer Discretionary	7.6%
Alphabet Inc.	Communication Services	6.9%
ServiceNow, Inc.	Information Technology	4.8%
Facebook, Inc.	Communication Services	4.7%
EPAM Systems, Inc.	Information Technology	4.3%
Adobe Inc.	Information Technology	3.8%
Intuitive Surgical, Inc.	Health Care	3.7%
Veeva Systems Inc.	Health Care	3.5%
ASML Holding N.V.	Information Technology	3.3%
Mastercard Incorporated	Information Technology	3.2%
Total		45.8%

* Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

innovation and relentless focus on the future that, in turn, has produced – and we believe will continue to produce – outstanding results for investors.

- **Durable competitive advantage** To build a sustainable competitive advantage in today's knowledge-based economy, we believe that a company must continually improve – the Japanese term is kaizen – and innovate. If a company stands still while its competitors move ahead, it will inevitably fall behind, lose its edge, and die. We think this is especially true given increasing digitization, or the shift to computer-processed information. In the digital era, innovation happens at a much more rapid pace than in the past as companies can iterate much faster, assessing the success of a product or service and challenging its capabilities to deliver something better. Digitization has moved well beyond traditional IT companies and is penetrating and transforming many other industries, including health care, banking, commerce, and consumer goods and services.
- **Platform business** About half of Baron Fifth Avenue Growth Fund is invested in companies that have built a platform that others can use to easily connect their businesses, market and sell their products and services, and co-create value. The other half are on their way to becoming platform companies, in our view. Users, sellers, providers, and others typically seek to work with these businesses, leading to better monetization opportunities over time. We think that, as a group, platform companies offer the most significant growth opportunities in the global market today as they benefit from economies of scale, the network effect, and formidable barriers to entry. We think our focus on identifying and investing in future platform companies gives us a competitive edge, as we are getting in on the ground floor where we see massive potential growth opportunities.

Although “platform” has become a buzzword, especially in technology, we think few businesses have earned the term. As a result of power law distribution effects, in which one or two providers will end up monopolizing an industry, the economies of scale, network effect, and barriers to entry that characterize the platform company can lead to dominance within its vertical market. Platform companies can be found in multiple industries, not just technology.

For example, health care company **Illumina, Inc. (ILMN)** is the leading platform for DNA sequencing, the process of determining the precise order of nucleotides within a DNA molecule. Illumina provides the tools used for over 90% of the world's sequencing output and is benefiting from a major shift into personalized medicine driven by DNA sequencing. It is already becoming common practice to sequence a cancerous tumor and prescribe drugs targeting the genetic mutations specific to that cancer. In the reproductive health arena, DNA sequencing is being used to help identify chromosomal abnormalities early in a pregnancy.

When we bought Illumina in 2011, the stock had been decimated by two missed quarters, reduced guidance, and the threat of a government shutdown (at the time, roughly one-third of revenue was from academic research, which relies on federal funding). None of this had to do with Illumina's competitive advantages or potential growth opportunities. We took advantage of the selloff to establish a position. The stock has appreciated more than 1,300% in the time we have owned it.

- **Exceptional management** Management can make or break a company. A great product or service will only rarely, if ever, save a mismanaged company. In addition, we believe a firm's unique culture – the shared values, attitudes, standards, and beliefs – is shaped by management. For these reasons, our assessment of the strength of a company's leadership is at the core of our research process. We look for a track record of successful capital allocation with proven ability to reinvest excess cash flows at high rates of return.
- **Recurring revenue and diverse customer base** From both a business and investor perspective, the recurring revenue model has many benefits, including predictable and measurable revenue, higher levels of customer retention, steady and repeatable cash flow, reduced risk and greater opportunities for growth. We also prefer a diverse customer base as it helps mitigate risk as well since the loss of one or two customers will not break the bank. Our concentrated portfolio necessitates that each of our holdings is diversified.
- **Pricing power** We prefer companies whose pricing power is tied to the utility of their product or service rather than a monopolistic grip on that product or service. For instance, we like software-as-a-service businesses, which use a subscription revenue model and typically become deeply embedded in customer workflows. This dynamic allows the vendor to raise prices in exchange for incremental improvements. A business that can raise prices without losing share to a competitor is a solid business, in our view.

Illumina, which we touched upon earlier, offers an excellent example of the pricing power we look for in a company. Its razor/razor blade business model means that a high percentage of its revenue is recurring, generating steady cash flow even when sales of its systems lag.

- **Valuation** We estimate the intrinsic value by forecasting the key financial metrics – revenue, margins, capex, depreciation, amortization, etc. – of every company we invest in and will only make the investment if we can buy it at 20% discount to that value. We also sell when the price moves up to over 20% above intrinsic value estimates. Our adherence to this principle means that we look for companies that are still relatively early in the growth stage of

their life cycle compared with other large-cap companies. It also differentiates us from many others who describe themselves as growth investors.

A Differentiated, Long-Term Approach to Risk

As we emerge from the COVID-19 pandemic and its impact on the economy and markets, risk understandably remains top of mind for many investors. However, we do not look at risk in the same way as most investors. We define risk as the possibility of a permanent loss of capital. At the securities level we seek to manage risk by investing in what we believe are well-managed high quality companies with low to no leverage, organic growth, a sustainable competitive advantage, recurring revenue, and high ROIC and free cash flow yield. On a portfolio level, we seek to manage risk by investing in companies with multiple end markets that are not necessarily correlated. In addition, although we are not all that sensitive to short-term macro events, we do take into consideration macroeconomic and geopolitical concerns such as government regulation, interest rates, inflation, and the like if we believe they will have a material impact on our investment thesis for a particular company.

Volatility has become synonymous with risk in many investors' minds, but we don't agree! Risk must be managed, but it is less obvious that volatility should or even can be managed effectively over time. We do

not manage for market volatility and we are not striving for short-term consistency. We own less than half of the names of an average large cap fund, because we believe there are a limited number of truly compelling investment ideas at any given time. As Warren Buffett puts it, "Very few people have gotten rich on their seventh best idea." The more concentrated nature of our Fund combined with our focus on long-term disruptors means that we will always be subject to volatility over the near term.

We acknowledge that the Fund may not be the best fit for the short-term investor who is concerned about volatility because of the increased probability of exiting at the wrong time. However, we believe the Fund is an excellent choice for the investor who is willing to overlook short-term noise in the interest of maximizing potential alpha over the long term.

Conclusion

We have been invested in companies we believed would be beneficiaries of digital transformation for years. Given how far we have moved into digital spaces in the past year and a half, it is hard to imagine going back to pre-pandemic physical alternatives. In fact, we don't think we will ever go back to the old normal. The pandemic has served only to *accelerate* the digital transformation that was already in play well before the pandemic and will continue well into the next decade and beyond.

Investors should consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The prospectus and summary prospectus contains 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.

Risk: 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. There is no guarantee that these objectives will be met.

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.

Portfolio holdings as a percentage of total investments as of 9/30/2021 for securities mentioned are as follows: **illumina, Inc.** 2.4%. As of 9/30/2021, the Fund did not hold shares of **Apple, Inc.** or **Microsoft Corporation**.

Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

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. The index performance is not Fund performance; one cannot invest directly into an index.

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.

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

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

Sharpe Ratio is a risk-adjusted performance statistic that measures reward per unit of risk. The higher the Sharpe ratio, the better a fund's risk adjusted performance.

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PRODUCTS WE OFFER

We offer 18 mutual funds in retail, institutional, and R6 share classes, collective investment trusts, separately managed accounts, sub-advisory services, UCITS, and other offshore vehicles.

STRATEGIES

BARON DISCOVERY STRATEGY
BARON SMALL CAP GROWTH STRATEGY
BARON OPPORTUNISTIC SMALL CAP GROWTH STRATEGY
BARON SMALL TO MID CAP GROWTH STRATEGY
BARON FOCUSED GROWTH STRATEGY
BARON MID CAP GROWTH STRATEGY
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MUTUAL FUNDS

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