INSIDE THE BARON FUNDS

INVESTOR

Baron Discovery Fund

Finding Growth Opportunities in Earlier Stage Small Cap Stocks

Many investors steer away from small-cap stocks, wary of their reputation as riskier and more volatile than their larger-cap counterparts. While this can be the case, we believe investors who avoid this asset class are missing out. In our opinion, small-cap stocks offer fantastic opportunities for research-driven investors who are able to do the deep dive to find the hidden gems. As a firm that got its start investing in small-cap stocks nearly 40 years ago, we are long-time believers in the potential for small caps to generate alpha for investors.

Baron Discovery Fund

Of the three small-cap funds Baron manages, Baron Discovery Fund is our newest. The Fund invests in earlier stage small-cap growth companies – stocks with market caps typically at or below the weighted average of the Russell 2000 Growth Index (currently $2.49 billion). It is co-managed by Randy Gwirtzman and Laird Bieger, who in addition to their six years as co-portfolio managers, have worked closely together for 12 years as research analysts at Baron. They each have 23 years of investment research experience. During their many years of working together, Randy and Laird have developed what we believe is a distinct approach to investing in small-cap equities.

As seen in the table to the right, this strategy has produced outstanding results over the six plus years since the Fund's launch. As of June 30, 2020, based on total returns, Morningstar has ranked the Fund in the 12th, 21st, and 11th percentiles in the Small Growth Category for the 1-year, 3-year, and 5-year periods, respectively. The Fund has a 4 star rating from Morningstar overall, as well as for the 3- and 5-year periods.

The Fund has an attractive upside capture of 116.04% and downside capture of 91.36% since inception. Its 6.72% alpha given its 1.04 beta since inception is equally impressive, especially in an asset class that is known for its volatility. The Fund has always maintained high active share. Its current active share is 93.9%.

Randy Gwirtzman and Laird Bieger
Co-Portfolio Managers

Baron Discovery Fund Performance
as of 6/30/20 (annualized)*

	1 Year	3 Year	5 Year	Since Inception**
Baron Discovery Fund	16.74%	15.70%	13.86%	15.65%
Russell 2000 Growth Index	3.48%	7.86%	6.86%	8.46%
Morningstar US Fund Small Cap Growth Category Average	4.46%	10.08%	8.28%	8.61%
Morningstar Percentile Rank	12%	21%	11%	3%

* Institutional shares. For retail and R6 shares, visit www.BaronFunds.com.
**9/30/2013

Performance listed in the above table is net of annual operating expenses. Annual expense ratio for the Institutional Share Class as of fiscal year ended September 30, 2019, was 1.10%.

The performance data quoted represents past performance. Past performance is no guarantee of future results. The investment return and principal value of an investment will fluctuate; an investor's shares, when redeemed, may be worth more or less than their original cost. The Adviser reimburses certain Baron Fund expenses pursuant to a contract expiring on August 29, 2030, unless renewed for another 11-year term and the Fund's transfer agency expenses may be reduced by expense offsets from an unaffiliated transfer agent, without which performance would have been lower. Current performance may be lower or higher than the performance data quoted. For performance information current to the most recent month end, visit www.BaronFunds.com or call 1-800-99BARON.

The Fund's 1-, 3-, and 5-year historical performance was impacted by gains from IPOs and/or secondary offerings, and there is no guarantee that these results can be repeated or that the Fund's level of participation in IPOs and secondary offerings will be the same in the future.

Please refer to p.4 for Morningstar disclosures.

Advantages of Small Cap Equities

Small-cap stocks enjoy several advantages, in our view. With roughly 2,400 listed U.S. stocks (excluding penny stocks), this category has plenty of companies to analyze. Small caps can offer greater and faster growth potential than their larger peers, as they are earlier in their growth trajectory and have captured just a small portion of their overall target market.

In addition, small caps tend to be underfollowed on Wall Street. On average, a large-cap company is followed by 25 analysts, compared with six for the average small cap. This sparser coverage in part is a reflection of SEC regulations that make it difficult for funds to own more than a certain percentage of a company. The result is that many large mutual funds forego small-cap companies because they cannot take a position big enough to have a material impact on their overall portfolio.

As active growth managers with the extensive research capabilities needed to spot promising companies early on, we think the relative lack of coverage gives us an advantage. A primary goal of active management is to add value by capitalizing on market inefficiencies. With many small-cap stocks flying under the radar, the inefficiency that results makes this space particularly suited to active managers. When compared to large caps, stock returns of smaller companies are more driven by company-specific events and less so by industry and market events.[1] This means the skilled stock picker who is able to understand and evaluate a company's idiosyncrasies has more opportunities in this asset class.

On the downside, small caps can be volatile. As long-term investors, we are accustomed to riding out short-term volatility, and will selectively take advantage of a downswing to initiate or build a position. As less well established businesses, small caps can also carry more risk than their larger peers. As detailed below, we take a multi-faceted approach to managing risk, which we believe is critical to successful management of a small cap portfolio.

A Differentiated Process

We like to say that investors have never heard of many of the companies in which we invest, but they will. We look for high-quality, fast growing, earlier stage companies in some of the most transformative and exciting areas of our economy. We find these companies by combining a thematic approach with bottom-up stock selection, backed by extensive due diligence. We believe this approach, combined with our disciplined management of risk, differentiates us from our peers.

We emphasize fast growing areas of the economy such as:

- Cloud computing
- Cybersecurity
- Semiconductors
- Defense and aerospace
- Genetics
- Minimally invasive surgical procedures
- Biotechnology and pharmaceuticals
- The use of technology in health care products and services
- Unique retail concepts

These are all transformational, secular trends – dynamic, evolving, and among the fastest expanding areas of the economy.

To build a portfolio around these and other themes, we leverage our industry expertise and extensive research experience and capabilities to source the most promising investment opportunities. Because we seek to invest only in stocks in which we have strong conviction, we generally hold just 60 to 70 names in the portfolio, compared with a category average of 166 stocks. The limited number of holdings, coupled with our long-term perspective, allows us to do the due diligence needed to gain an in-depth understanding of these companies, including getting to know their management teams and visiting key sites they may hold. It also gives us the chance to research new investment prospects. As with all Baron Funds, we look for what we believe are strong management, sustainable competitive advantages, and open-ended growth opportunities, at an attractive valuation.

An Integrated Approach to Managing Risk

Smaller companies can enjoy phenomenal growth in a short period of time. However, as any small cap portfolio manager can attest, they can have volatility on the downside as well. Although we are long-term investors, the volatility of this asset class demands that we incorporate risk management into every aspect of our investment process. We think our comprehensive approach to risk is reflected in our beta since inception of just 1.04, which we believe is highly unusual among smaller-cap, high-growth portfolio managers, especially given our alpha of 6.72%. The dimensions of our approach include

- Extensive due diligence
- Balance among growth profiles
- Dynamic valuation analysis
- Position sizing
- Industry exposures
- Predictable revenue and cash flow in the largest positions

Extensive due diligence We believe the best risk management starts with knowing our companies. We evaluate the strength of their management teams, competitive advantages, and long-term growth prospects, and determine the appropriate valuation based on our independent research. Of course, this is the same investment process that we employ to generate potential alpha as well. When we look at a balance sheet, we focus on free cash flow relative to overall debt. If the cash flow is recurring and predictable, the company can have higher leverage. If the cash flow is less predictable, we will want to see a lower debt burden.

Balance among growth profiles We seek to balance the portfolio among high growth, growth, and what we call "other" or sometimes "ballast" stocks to help manage risk. Weights for each category are typically 40% in high growth, 40% in growth, and 20% in other/ballast.

- *High growth* These are higher risk/return companies typified by revenue growth of 20% or more that we believe will lead to dramatic future earnings growth. This category includes newer businesses with novel products or services. Yet they are not venture businesses. We invest only in companies with fully formed business strategies. For

[1] A 2016 Deutsche Bank Research study found that roughly 85% of small-cap stock returns were driven by company-specific events compared to only about 60% in the large cap space. Source: "Quantitative Study, The Quant View," by Deutsche Bank Markets Research, 9/7/16.

Baron Discovery Fund
Top 10 Holdings as of 6/30/20*

Holding	Sector	% of Net Assets
Kinsale Capital Group, Inc.	Financials	4.0%
Floor & Decor Holdings, Inc.	Consumer Discretionary	3.0%
SiteOne Landscape Supply, Inc.	Industrials	2.9%
Endava plc	Information Technology	2.9%
CareDx, Inc.	Health Care	2.7%
Emergent BioSolutions Inc.	Health Care	2.6%
Qualys, Inc.	Information Technology	2.5%
Mercury Systems, Inc.	Industrials	2.5%
Americold Realty Trust	Real Estate	2.3%
TPI Composites, Inc.	Industrials	2.3%
Total		**27.7%**

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

example, in biotechnology and pharmaceuticals, we favor companies with either approved drugs, large pipelines addressing multi-billion dollar clinical market opportunities, or companies that have wrapped intellectual property around an already proven pharmaceutical to create a new, protected franchise.

We are invested in transplant diagnostic company **CareDX, Inc.**, the market leader in HLA (human leukocyte antigen) typing used for blood or marrow transplants and heart transplant testing. The company recently launched a kidney transplant test, which addresses a large market opportunity and has higher margins than its other tests. We believe sales can grow from $65 million annually to well over $200 million in 2022 as penetration increases.

- *Growth* These are companies with revenue growth of around 10% to 20% that we think will lead to greater future cash flow and earnings growth due to expanding margins. These firms tend to be more established than their high-growth counterparts.

  Cybersecurity software company **Qualys, Inc.** is a good example of a growth investment. Its software conducts customer network analysis to tag unauthorized changes and maintenance issues. We like this business for its high percentage of recurring revenue and free cash flow margins. We believe Qualys has large growth opportunities driven by its core cybersecurity offering and launch of new products.

  Sientra, Inc., a medical device company, is one of three suppliers that has FDA approval to market silicone gel breast implants in the United States. Surgical breast implants are a $650 million market in the United States with high barriers to entry due to its long FDA approval process. We expect the company to grow in its current market with limited competition and expand into additional aesthetic areas through acquisitions such as Miramar Labs in 2017.

- *Other/Ballast* This category is constructed to help dampen volatility by offsetting holdings in other parts of the portfolio that may have higher beta. This category is also typically not as correlated to the market as the other two. These holdings might be more yield- or asset-oriented and generate solid free cash flow growth. They could also be special situations where we see valuation upside in a company that is new to the market through a spinoff, IPO, or restructuring; a company with a strong business that has been mismanaged but has a new, better management team; or a "fallen angel" (a great company that has stumbled for some reason).

  Two examples in this category are **Mercury Systems, Inc.**, an electronic subsystems provider to major defense contractors, and **Americold Realty Trust**, a temperature-controlled warehouse operator. Mercury is known for high-quality products delivered on time and on budget, all of which is critically important for missile defense, radar, and electronic warfare applications. We believe its estimated 20% market share of the $2 billion to $2.5 billion market for outsourced defense electronics will grow as outsourcing increases among tier-1 defense contractors worldwide.

  We initiated a position in Americold following its IPO in early 2018. We like the cold storage business because of its stability, "mission critical" nature, and growth opportunities. Cold storage is critical to food consumption, which is directly tied to population growth. We believe Americold's proprietary technology platform is a differentiator. The company's valuation is attractive, its growth prospects are solid, and it benefits from being in a less cyclical business, in our view.

  We also employ a concept that we call investing in reverse. At times, we come across a company that checks all the boxes – great management, a terrific business plan, product or service, an open-ended growth opportunity – but is too expensive in our view. We will continue to conduct due diligence and update its valuation because, in our experience, we think we will be able to buy the stock on a dip that brings it below our calculation of valuation.

Dynamic valuation analysis We are active managers not only in our stock selection process, but also in our strict valuation focus during our investment holding period. Just as we will not buy a stock if we think the valuation is too high, we also re-balance the portfolio regularly according to our own calculations of valuation and price targets for each holding. We continually update valuation with one-, three-, and five-year targets for each holding. Should a stock get over-valued on a medium or long-term basis, we will trim and reinvest the proceeds in other companies, which serves to continually de-risk the portfolio.

We also seek to manage risk by diversifying the portfolio across sub-industries with uncorrelated drivers of growth. In every bull market, there are sub-industries in bear markets, and vice versa. Because we invest across a wide range of sub-industries, we will use the cash generated from trimming a position or flows to initiate or build a position in a sub-sector where we see value.

Position sizing We limit the number of holdings in the portfolio, which allows us to focus on stocks in which we have high conviction and devote resources to doing as deep a dive as possible on each company we invest in. To hedge against the potential volatility and risk of a more concentrated fund, we manage the portfolio so that no one holding exceeds 4% by weight for an extended period of time.

Industry weightings Another way in which we seek to minimize beta is by managing the portfolio so that with regard to industry weightings, we do not stray too far from the benchmark. This strategy is partly by design because as long-term investors and bottom-up stock pickers, we are not in the business of making market or industry bets. However, it is also because the heaviest index weightings – Information Technology and Health Care – are where we find the growth in today's economy.

Predictable revenue and cash flow in the largest positions At any given time, the top 10 stocks in the portfolio comprise roughly 25% to 35% of assets. These companies, which are listed in the table on the previous page, have relatively more predictable revenue and cash flow, which helps to hedge against potential volatility.

Conclusion

We believe that valuations for our current investments leave room for significant upside over the medium and long term (which we define as a three- to five-year period). We continue to look for our targeted returns on each of our investments on an individual basis. Our enthusiasm has not waned a bit, and we continue to analyze, visit, and question management teams for each of our portfolio companies as well as for many other companies that could become new portfolio companies.

We encourage you to take a closer look at Baron Discovery Fund. As significant personal investors in their own Fund, Randy and Laird are committed to maintaining its outstanding track record of performance. Of course, there are no guarantees.

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

Risks: Risks associated with investing in smaller and medium sized companies include that the securities may be thinly traded and they may be more difficult to sell during market downturns. Even though the Fund is diversified, it may establish significant positions where the Adviser has the greatest conviction. This could increase volatility of the Fund's returns.

The discussions of the market trends and 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 managers' 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 June 30, 2020 for securities mentioned are as follows: **CareDX, Inc.** – 2.7%; **Qualys, Inc.** – 2.5%; **Sientra, Inc.** – 1.0%; **Mercury Systems, Inc.** – 2.5%; **Americold Realty Trust** – 2.3%.

Baron Discovery Fund Institutional Share Class is in the **Morningstar US Fund Small Growth Category**. Morningstar calculates the category average using the Morningstar Fractional Weighting methodology. Morningstar rankings are based on total returns and do not include sales charges. Total returns do account for management, administrative, and 12b-1 fees and other costs automatically deducted from fund assets. As of 6/30/20, the category consisted of 625,577,508, and 455 share classes for the 1-, 3-, 5-year, and since inception periods. **Baron Discovery Fund** Institutional Share Class ranked in the 12th, 21st, 11th, and 3rd percentiles, respectively.

As of 6/30/2020, Morningstar had awarded **Baron Discovery Fund** Institutional Share Class 4 stars for its 3-year, 5-year, and overall performance.

The Morningstar Rating™ for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent 3-year period actually has the greatest impact because it is included in all three rating periods.

Russell 2000® Growth Index measures the performance of small-sized U.S. companies that are classified as growth. An investor cannot invest directly in 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.

Active Share is a term used to describe the share of a portfolio's holdings that differ from that portfolio's benchmark index. It is calculated by comparing the weight of each holding in the Fund to that holding's weight in the benchmark. Positions with either a positive or negative weighting versus the benchmark have Active Share. An Active Share of 100% implies zero overlap with the benchmark. Active Share was introduced in 2006 in a study by Yale academics, M. Cremers and A. Petajisto, as a measure of active portfolio management.

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.

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