Baron Opportunistic Small Cap Growth Strategy

June 30, 2023

Dear Investor:

Performance

Baron Opportunistic Small Cap Growth Strategy® was up 6.50% in the second quarter of 2023 and was up 16.57% for the first half of the year. For the quarter, the Strategy performed similarly to the Russell 2000 Growth Index (the Benchmark) and for the year-to-date period is about 300 basis points ahead. The Strategy trailed the broader S&P 500 Index this quarter, as larger stocks outperformed smaller ones. Year to date, the Strategy's performance is comparable to the S&P 500 Index.

As shown in the table below, the Strategy has outperformed its Benchmark for most of the relevant periods. Over its more than 25-year history, the Strategy has outperformed its Benchmark by 353 basis points a year, which is meaningful outperformance.

Table I.
Performance for annualized periods ended June 30, 2023 (Figures in USD)[1]

	Baron Opportunistic Small Cap Growth Strategy (net)[2]	Baron Opportunistic Small Cap Growth Strategy (gross)[2]	Russell 2000 Growth Index[2]	S&P 500 Index[2]
Three Months[3]	6.50%	6.77%	7.05%	8.74%
Six Months[3]	16.57%	17.15%	13.55%	16.89%
One Year	17.12%	18.30%	18.53%	19.59%
Three Years	8.00%	9.08%	6.10%	14.60%
Five Years	8.47%	9.55%	4.22%	12.31%
Ten Years	10.46%	11.57%	8.83%	12.86%
Fifteen Years	10.20%	11.32%	8.85%	10.88%
Since Inception (December 31, 1997)[4]	10.01%	11.27%	6.48%	8.14%

Table II.
Calendar Year Performance 2018-2022 (Figures in USD)

	Baron Opportunistic Small Cap Growth Strategy (net)[2]	Baron Opportunistic Small Cap Growth Strategy (gross)[2]	Russell 2000 Growth Index[2]	S&P 500 Index[2]
2018	(7.09)%	(6.15)%	(9.31)%	(4.38)%
2019	34.93%	36.29%	28.48%	31.49%
2020	40.82%	42.23%	34.63%	18.40%
2021	15.87%	17.03%	2.83%	28.71%
2022	(31.03)%	(30.34)%	(26.36)%	(18.11)%

The market continued to perform well in the second quarter, led by outsized gains in technology stocks and a handful of mega-cap stocks driving performance. The NASDAQ Composite Index rose 13.1% in the second quarter, bringing its year-to-date return to 32.3%, its best start to a year since the early 1980s, with excitement over developments with artificial intelligence (AI) fueling the rally. We think the main reason the market rose in the quarter, despite concerns about a banking crisis, threats of a U.S. default, and continued interest rate increases by the Fed, is because the feared worst case scenarios failed to materialize. Most prominent is that the recession/hard landing that so many economists and market prognosticators have predicted has not happened. In fact, it has been just the opposite, as economic data has largely been strong. And with inflation cooling significantly, expectations are that the Fed will slow or stop raising rates in the near future. Though the economic outlook remains murky, the slowdown, which the consensus seemed to view as almost inevitable, is now less likely. Investors are out of their funk and embracing the prospect that better growth could be ahead.

For Strategy reporting purposes, the Firm is defined as all accounts managed by Baron Capital Management, Inc. ("BCM") and BAMCO, Inc. ("BAMCO"), registered investment advisers wholly owned by Baron Capital Group, Inc. As of June 30, 2023, total Firm assets under management are approximately $41.8 billion. Gross performance figures do not reflect the deduction of investment advisory fees and any other expenses incurred in the management of the investment advisory account. Actual client returns will be reduced by the advisory fees and any other expenses incurred in the management of the investment advisory account. A full description of investment advisory fees is supplied in our Form ADV Part 2A. Valuations and returns are computed and stated in U.S. dollars. Performance figures reflect the reinvestment of dividends and other earnings. The Strategy is currently composed of one mutual fund managed by BAMCO. BAMCO and BCM claim compliance with the Global Investment Performance Standards (GIPS®). To receive a complete list and description of the Firm's strategies or a GIPS Report please contact us at 1-800-99BARON. GIPS® is a registered trademark owned by CFA Institute. CFA Institute does not endorse, promote or warrant the accuracy or quality of the report.

Performance data quoted represents past performance. Current performance may be lower or higher than the performance data quoted. Past performance is no guarantee of future results.

1 With the exception of performance data, most of the data is based on a representative account. Such data may vary for each client in the Strategy due to asset size, market conditions, client guidelines, and diversity of portfolio holdings. The representative account is the account in the Strategy that we believe most closely reflects the current portfolio management style for the Strategy. Representative account data is supplemental information.

2 The **Russell 2000® Growth Index** is an unmanaged index that measures the performance of small-sized U.S. companies that are classified as growth. The **S&P 500 Index** measures the performance of 500 widely held large-cap U.S. companies. All rights in the FTSE Russell Index (the "Index") vest in the relevant LSE Group company which owns the Index. Russell® is a trademark of the relevant LSE Group company and is used by any other LSE Group company under license. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. The Strategy includes reinvestment of dividends, net of foreign withholding taxes, while the **Russell 2000® Growth Index** and the **S&P 500 Index** includes reinvestment of dividends before taxes. Reinvestment of dividends positively impacts performance results. The indexes are unmanaged. Index performance is not Strategy performance. Investors cannot invest directly in an index.

3 Not annualized.

4 The Strategy has a different inception date than its representative account, which is 9/30/1997.

Table III.
Top contributors to performance for the quarter ended June 30, 2023

	Percent Impact
Vertiv Holdings Co	2.08%
Kinsale Capital Group, Inc.	0.93
SiteOne Landscape Supply, Inc.	0.73
ICON Plc	0.65
Chart Industries, Inc.	0.62

Small-cap stocks underperformed for the quarter but did improve with a broader market rally. A healthy sign. The Strategy was having an average quarter until June, when our stocks were strong on an absolute and relative basis. The strong performance came from some of our large positions that rose on improved outlooks for their business fundamentals. For the quarter, our stock selection was positive. Our holdings in the Industrials, Consumer Discretionary, and Financials sectors performed well. We are overweight in each of these sectors, so this helped our relative performance as well. Our Health Care stocks performed well; however, we have a significant underweight position in that sector because we do not own biotechnology stocks, which outperformed the Benchmark during the quarter and hurt our relative performance. Our Information Technology stocks did poorly this quarter, since we focus on service businesses and vertical software companies, and these businesses suffered as their customers are focused on cost savings, for now. We primarily invest in high-quality companies and those stocks have done relatively poorly as rallies often start with more speculative stocks. Our larger-cap orientation helped our performance.

As we suspected (and wrote about last year), many of our best performers and highest contributors year to date were some of our biggest losers last year. That has played out in spades. For instance, as interest rates rose dramatically in 2022, some of our stocks got pummeled over concerns that their businesses would collapse. But the companies are doing fine, and their prospects are now turning positive. **SiteOne Landscape Supply, Inc.**, **Floor & Decor Holdings, Inc.**, **Installed Building Products, Inc.**, and **Trex Company, Inc.** each fell over 35% last year, but are up over 40% so far this year. Other stocks that were down a lot last year and are up big this year include **ICON Plc**, **Chart Industries, Inc.**, **Guidewire Software, Inc.**, **Cognex Corporation**, **Vertiv Holdings Co**, **John Bean Technologies Corporation**, **European Wax Center, Inc.**, **Altair Engineering Inc.**, **The Trade Desk**, and **Dechra Pharmaceuticals PLC**.

Vertiv Holdings Co provides critical digital infrastructure for data centers. Its shares rose sharply after Vertiv reported strong earnings, featuring 35% organic sales growth and increased 2023 guidance, which helped improve management credibility regarding margin expansion plans. In addition, the stock's trading multiple increased on the belief that Vertiv stands to benefit from generative AI-related data center investments. Generative AI will require an increase in energy density due to the need for additional computing power, which, in turn, will necessitate new cooling solutions. Vertiv should be able to leverage its leadership position in air cooling, strong relationships with customers, and dominant service network to gain share and grow rapidly. We believe Vertiv's earnings power will increase as the company closes the margin gap with peers and revenue grows on the back of increased investments in data centers.

Specialty insurer **Kinsale Capital Group, Inc.** contributed to performance after reporting consensus-beating quarterly results. Gross written premiums grew 46%, and EPS grew 49%, the fifth consecutive quarter of over 40% premium growth. Market conditions remained favorable, with rising premium rates and more business shifting from the standard lines market to the excess and surplus lines market where Kinsale operates. Recently, a major underwriter announced it will stop underwriting comparative insurance in California, which opens up more market share for Kinsale. The company is also capitalizing on disruption in the property market where rates are rising rapidly after years of industry losses and a reduction in reinsurance capacity. Kinsale is well managed and has a long runway for growth in an attractive segment of the insurance market.

SiteOne Landscape Supply, Inc. is the largest distributor of wholesale landscape supplies in North America, selling irrigation, hardscape, agronomic, and nursery products to professional contractors through its network of branches for residential and commercial maintenance, upgrade/repair, and new construction applications. Shares rose during the quarter after the company reported positive early season order trends. Shares were also boosted by the continued broader recovery in sentiment for housing-related stocks. We believe SiteOne will take share of the fragmented wholesale landscape supplies distribution industry leveraging its scale, operational efficiency, and technology, while strategically acquiring companies that expand its product offering and geographic footprint, which together will drive consistent EBITDA growth. Though we expect cash flow to be lower this year, we are modeling that it will double over the next five years, and the company will generate significant free cash flow to fund acquisitions while deleveraging its balance sheet.

Other holdings that rose 20% or more in the quarter but contributed less to the Strategy's returns include Chart Industries, Installed Building Products, Dechra, Trade Desk, Trex, **Inspire Medical Systems, Inc.**, **TransDigm Group Incorporated**, **Bright Horizions Family Solutions, Inc.**, **DraftKings Inc.**, and **Holley Inc.**

Table IV.
Top detractors from performance for the quarter ended June 30, 2023

	Percent Impact
Aspen Technology, Inc.	–0.57%
Mercury Systems, Inc.	–0.53
The Beauty Health Company	–0.40
ASGN Incorporated	–0.34
Endava plc	–0.33

Shares of industrial automation software leader **Aspen Technology, Inc.** detracted from performance during the quarter. Aspen reported mixed financial results due to a slowdown in its chemicals end-market, caused by downstream destocking. Also, there are some integration issues related to its merger with a subsidiary of Emerson Electric Company in 2022. While the integration went smoothly for about the first six months, it has hit some speed bumps lately. We view the issues as a temporary outcome of large business transformations and the decline in the chemical vertical as a short-term cyclical event. We believe Aspen's long-term FCF potential is intact, and the current price offers attractive potential returns for shareholders. We also expect the company to do accretive acquisitions to add further value.

Shares of **Mercury Systems, Inc.**, a leading U.S. Tier 2 defense electronics integrator, declined in the quarter. The company suffered financial misses in 2022 and early 2023 due to delays in the government defense budget, and delivery failures by suppliers and other supply-chain issues. During this period, multiple activist investors bought shares of the company and acquired Board seats, pressing the company to pursue strategic alternatives. In late June, Mercury announced the process had ended without a sale and its long-time CEO was stepping down. The shares fell on the news. We were disappointed and sold some of our position. We have since spent some time with new management and Board members and see value above where the stock is trading, so we have maintained a position, albeit smaller, as we continue to assess the situation.

The Beauty Health Company, owner of HydraFacial, is an innovative skin care and beauty health company providing consumers with the benefits of a professional medical treatment combined with the experience of a consumer brand. Shares fell after reporting weak top-line results due in part to the lingering impact of COVID-related lockdowns in China at the start of the year. In addition, some providers held back orders in advance of an upcoming product launch. Despite these temporary headwinds, the company raised its revenue guidance for the year, a testament to the strong demand for the brand. We believe the company has a long growth runway ahead, as it expands the number of delivery systems globally. We also believe it can increase its consumables-related revenue as it introduces new boosters and builds brand awareness. We like operating management and respect the executive chairman, who has overseen the building of highly successful franchises in the sector.

Other holdings that declined over 20% in the quarter but detracted less from the Strategy's returns were **Endava plc** and **Sprout Social, Inc.**

Portfolio Structure & Recent Activity

As of June 30, 2023, we had $4.4 billion under management and held 61 stocks. The top 10 positions made up 35.6% of net assets. The portfolio is somewhat more concentrated and top heavy than in the past. This is the result of the strong performance of most of our larger holdings.

Our largest positions are usually a collection of long-term holdings whose returns have compounded well and are familiar to followers of the Strategy. As you peruse the present list below, you will notice some stocks that are more recent purchases (Chart bought in 2022, Vertiv and Kinsale bought in 2019).

Table V.
Top 10 holdings as of June 30, 2023

	Year Acquired	Quarter End Investment Value (millions)	Percent of Net Assets
Gartner, Inc.	2007	$236.5	5.3%
Vertiv Holdings Co	2019	189.5	4.3
Kinsale Capital Group, Inc.	2019	187.1	4.2
ICON Plc	2013	175.1	3.9
SiteOne Landscape Supply, Inc.	2016	159.0	3.6
Floor & Decor Holdings, Inc.	2017	140.3	3.2
ASGN Incorporated	2012	132.4	3.0
Red Rock Resorts, Inc.	2016	128.6	2.9
Chart Industries, Inc.	2022	119.8	2.7
Installed Building Products, Inc.	2017	112.1	2.5

At the end of the quarter, the sectors with the highest concentration were Industrials (30.4%), Consumer Discretionary (15.7%), IT (15.6%), and Health Care (14.0%). Compared to the Benchmark, we are notably overweight in Industrials, overweight in Consumer Discretionary, and meaningfully underweight in Health Care. We don't own any Utilities or Energy stocks and are underweight in IT, Materials, and Consumer Staples.

To reiterate points we have made in the past, the Industrials companies we own are high-quality franchises that are benefiting from secular tailwinds and/or are unique leaders in their niches. Their success and our investment are an expression of their market position and long-term opportunity, not a view on the economy. In the Health Care sector, we don't own biotechnology stocks as their financial results can be binary or speculative in nature, and as we prefer to invest in what we consider established winners. Biotechnology stocks performed particularly well this quarter, which was a headwind to our relative performance, but we prefer to live with that as opposed to contravening our discipline. We are underweight the other sectors mentioned because there are fewer differentiated special businesses in those sectors.

We believe that we have successfully implemented our differentiated approach, which involves long-term investments in high-quality, special, and well-managed businesses, leading to positive long-term results. Our experience and expertise enable us to identify companies with significant growth potential, transforming from small operations into successful enterprises. Through thorough research and extensive dialogue with operating management, we gain a deep understanding of these businesses and closely monitor industry and competitive dynamics to stay informed about our investments' present and future prospects.

Investing for the long term requires courage and conviction to see beyond market noise and focus on the fundamentals of the businesses we invest in. We possess the courage to make informed decisions based on our deep understanding of our invested companies and the opportunities they present. Our management of the Strategy is informed by our past successes, allowing us to nurture our winners by providing ongoing support and selling stocks in which we have less confidence – what we refer to as "watering our flowers" and "cutting our weeds," respectively.

We have had some impressive winners over time. For instance, we bought **DexCom, Inc.** at a $950 million market cap in 2012, and it is now valued at $50 billion (the stock has appreciated 41% annually since the Strategy's initial purchase). **TransDigm Group Incorporated** has grown from $1.1 billion at purchase to $49 billion presently (and the stock has appreciated 29% annually since the Strategy's initial purchase 17 years ago). **IDEXX Laboratories, Inc.** has gone from $2 billion at purchase to $42 billion over almost 15 years and the stock has appreciated 26% annually during that time frame. **The Trade Desk** is now valued at $38 billion and was $433 million when we first purchased shares over 6 years ago. The stock has appreciated almost 60% annually since our initial purchase. All four stocks have been solid performers this year, contributing nicely to the Strategy's returns.

Since we manage a small-cap strategy but want to hold on to these great investments as they continue to compound and perform, we reduce the positions sizes over the holding period so that the overall market capitalization of the Strategy is palatable. For each of the four stocks mentioned above, we presently own 11% or less of our peak positions. We take the proceeds from the trimming of these positions to fund new small-cap investments, with the hopes of somehow replicating these results.

Looking at the stocks in the Strategy at the end of June, we have 13 investments that have appreciated more than five times since our initial purchase. These stocks make up 29.1% of the portfolio, and 19 more stocks that make up another 35.7% of assets whose share prices have more than doubled since our initial investment. About half of our holdings and about two-thirds of our assets have gone up significantly already, and we believe they will continue to be strong investments going forward.

Table VI.
Top net purchases for the quarter ended June 30, 2023

	Quarter End Market Cap (billions)	Net Amount Purchased (millions)
Neogen Corp.	$4.7	$16.8
The Beauty Health Company	1.1	8.3
Driven Brands Holdings Inc.	4.5	5.4
Sprout Social, Inc.	2.6	3.1
Endava plc	2.9	1.8

During the quarter, we did not add any new positions. This was unusual. We like what we own and are comfortable running a somewhat more concentrated portfolio, so we are not perturbed. We do have some dry powder, carrying a little over 4% in cash. The IPO market is starting to come back to life, which has always been a fertile hunting ground for new investments for us. Some fine companies will be the first to go public, but so far, the pricing has been frothy, so we haven't participated.

We did add to existing positions, namely **Neogen Corp.**, **The Beauty Health Company**, and **Driven Brands Holdings Inc.** We have gained more conviction in their businesses, and sometimes we are buying more when the stocks have been weak for reasons that don't affect our long-term thesis.

Table VII.
Top net sales for the quarter ended June 30, 2023

	Market Cap When Acquired (billions)	Quarter End Market Cap or Market Cap When Sold (billions)	Net Amount Sold (millions)
Hillman Solutions Corp.	$2.3	$ 1.7	$17.6
Gartner, Inc.	2.2	27.7	13.1
Mercury Systems, Inc.	0.8	2.0	12.6
SiteOne Landscape Supply, Inc.	1.1	7.5	7.9
Inspire Medical Systems, Inc.	1.3	9.5	7.2

We sold out of our small position in **Hilman Solutions Corp.** as the leverage in the business remains high, partly preventing a pathway to inorganic growth (a value driver in the past) to supplement a low organic growth profile. We believe other opportunities offer better upside and more dimension. We trimmed other names to manage their respective position sizes in the portfolio, like **Gartner, Inc.**, **SiteOne Landscape Supply, Inc.**, and **Inspire Medical Systems, Inc.**

Outlook

The stock market remains very strong in July, defying expectations. Investors are encouraged by the rate of decline in inflation and the continued strength of the economy. The June CPI figure was the latest impetus to the rally. Inflation cooled to its slowest pace since 2021, registering 3.0% for the year ended June 2023, down from a peak of 9.1% just a year earlier. *Core* inflation, which the Fed has focused on, was just 0.2% in the month of June.

The most recent employment report also pleased market participants. Hiring slowed, but wage growth was solid. The 3.6% unemployment rate reinforces the resilience of the economy. The Fed is expected to raise the Fed Funds rate at its next meeting, after pausing at the last one. Though inflation is still above its 2% target, it is trending sharply in the right direction, so it seems like we are nearing the end of rate hikes.

Could it be that inflation will return to a more manageable level without the need to endure an economic slowdown? This scenario, referred to as "immaculate disinflation" by one economist, suggests that we can achieve lower inflation without facing a recession. It now appears to be a possible, and perhaps even likely, outcome, a possibility that was not seriously considered earlier in the year. The thesis is grounded in the idea that severe inflation was caused by shockwaves from the pandemic, which led to excessive stimulative fiscal and monetary policy, creating a buying binge in a time of troubled supply chains and distortions in the commodity markets from the war in Ukraine. Now all that is passing, and inflation is naturally abating. Well, maybe. This possibility is behind the recent optimism driving stocks higher in my opinion.

On the other hand, some argue that a recession may be on the horizon, even if it's not yet evident. We just lived through unprecedented quantitative tightening, and monetary policy works with lag effects usually of 18 to 24 months, and we are just 16 months from the start of the rate hikes. Many economists we respect are convinced that higher rates will weigh on the economy and odds are high the economy will roll over soon. Other elements of the bear case are that consumers are running through their resources and inevitably will cut back spending. Financing shocks or crisis situations are bound to recur. The Fed will likely continue to raise rates or hold rates high until inflation registers at the Fed's stated goals, so as not to repeat past mistakes, which helped result in runaway inflation. Corporate earnings are about to weaken significantly, and stock multiples will contract.

We are seeing a broadening of the market rally. The capital markets and IPOs are coming back to life. Consumer confidence is improving. Housing has rebounded, even in the face of much higher mortgage rates. All healthy signs. And though small caps are now outperforming, they are still far off their record highs, twice the differential of other indexes. Is this a bear rally or the beginning of a bull run? We will see.

We look forward to hearing from our companies about what they are seeing in their businesses and broader economy. We suspect some continued moderation in growth, but we don't foresee major headwinds. How our companies do will determine how their stocks perform. Over the longer term, we have great confidence in the future earnings growth of our holdings and think their stock prices do not reflect where we believe their businesses are heading.

Cliff Greenberg
Portfolio Manager

The performance of accounts in the Strategy may be materially different at any given time. Differences that may affect investment performance include cash flows, inception dates, and historical prices. Positions may not be the same or may be traded at different times. In addition, accounts in the Strategy may be pursuing similar investment strategies but may have different investment restrictions.

Risks: Past performance is not a guide to future performance. The value of investments and income from them may go down as well as up. Your capital is at risk. Specific risks associated with investing in smaller companies include that the securities may be thinly traded and more difficult to sell during market downturns. Even though the Strategy is diversified, it may establish significant positions where the Adviser has the greatest conviction. This could increase volatility of the Strategy's returns.

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

The discussions of the companies herein are not intended as advice to any person regarding the advisability of investing in any particular security. The views expressed in this report reflect those of the respective portfolio manager 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.