

BEST MUTUAL FUND AWARDS

Baron Fund Finds Winning Stocks And Holds Long Term

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In a frenetic investment world where stocks are frequently traded on their price outlook in the next five minutes, five days or five months, Baron Partners Fund^{BPTRX} is an outlier. The \$2.7 billion growth fund is all about patience. It buys shares of companies with the goal of hitting pay dirt not tomorrow, but in five years.

The result of that strategy put Baron Partners among the best growth mutual funds in terms of performance. Baron Partners' returns surpassed the S&P 500's in the one, three, five and 10 years ended Dec. 31. In so doing, it has earned an IBD Best Mutual Funds Award for 2020 in the Midcap Fund category. It's one of 16 Baron funds that have won IBD awards this year.

This buy-and-hold fund isn't a "closet" index fund. It doesn't own hundreds of stocks with the goal of keeping pace with the benchmark S&P 500. Baron Partners Fund is built to beat the market.

It does that by concentrating its bets only on the companies — it holds just 30 stocks — that it has the most conviction in. Companies that the fund gets to know just as well as family members. Companies that are disrupters like **Tesla**^{TLA}, core steady growers like veterinary diagnostics company **Idexx Laboratories**^{IDXX}, and names like mountain resort operator **Vail Resorts**^{MTN} that operate "irreplaceable" businesses. Then there's financial firms like

Charles Schwab^{SCHW} that have low capital requirements.

"We buy companies we believe will double in value over the next five years and then double again five years after that," co-portfolio manager Michael Baron, 38, told IBD. "We don't want to dilute those high-conviction names by mimicking the index. We want to be different from the index. We don't want to get paid for being average." (The fund has an above-average annual expense ratio of 2.03%.)

The lead manager of the fund, is Michael's dad, Ron Baron, CEO of the Baron Funds.

Attempting to double an investor's money in five years isn't about hitting doubles. It's about hitting home runs.

And Baron Partners' performance clout is what makes it one of the best growth mutual funds. It gained 44.99% last year, handily topping the S&P 500's 31.49% return. The fund also outpaced the S&P 500 in the past three-, five- and 10-year periods. Baron Partners, which uses leverage (borrowed money) to amplify returns, has posted an average annual return of 16.09% over the past 10 years vs. a 13.56% gain for the S&P 500.

The fund's long-term outperformance has been driven by its strategy of identifying companies with great growth opportunities. It then keeps constant tabs on them and holds them for long periods. Baron said the fund's "extremely low" 13% turnover "means we hold our stocks an average of seven years." That compares with a holding period of less than one year for the aver-



Baron Partners Fund

Michael Baron's concentrated fund uses leverage to augment returns.

age U.S. stock fund.

"It's a vastly different approach," Baron said. "We buy companies that have a competitive advantage and who over a time period of five to 10 years aren't going to see competition come in and disrupt them."

The fund runs a concentrated strategy. At the time of the interview, the fund's top-10 holdings accounted for a whopping 98% of total fund assets, Baron told IBD.

At the end of 2019, the fund's top holding was **CoStar Group**^{CSGP}, an online real estate analytics company that accounted for 18.4% of fund assets. The second-biggest holding was electric-car maker **Tesla**, with a 16.9% weighting. Other top-10 holdings included reinsurer **Arch Capital Group**^{ACGL}, **Idexx Laboratories**, lodging company **Hyatt Hotels**^H, **Vail Resorts**, finance data provider **FactSet Research Systems**^{FDS}, Charles Schwab, and online real estate player **Zillow**^Z.

The fund's long-term holding period and emphasis on high-quality companies enable it to look past the periodic short-

term downturns that often shake out investors less committed to companies they own.

The coronavirus that causes Covid-19 has taken some of the shine off the fund this year. It had plunged 34% for the year as of March 20 vs. declines of 37% for its midcap growth peers tracked by Morningstar.com and 28% for the S&P 500. A plunge like that suggests the fund hasn't taken much evasive action to staunch the red ink.

Baron said he couldn't comment intraquarter on what moves, if any, the fund was making in the face of the bear market. But he spoke optimistically about the outlook.

"We are positive on the market and positive on the economy, but even more positive on our underlying stocks," Baron said. "It's not spooking us as long as we're confident in the business fundamentals, the financial stability and the health of the balance sheets of the companies we are investing in — which we are."

Still, Baron doesn't dispute that some holdings could face de-

clines due to travel restrictions. Vail Resorts stock has plummeted 43% from its 12-month high. Hyatt stock is down 49%.

“There will be short-term disruption,” Baron said. “But we understand that these are everlasting businesses that are competitively advantaged and can survive any kind of disruption they might see.”

The managers of this best growth mutual fund spend very little time thinking about short-term macro conditions. Why? It’s unlikely to change the long-term growth trajectory of their holdings, Baron says.

“We think that even if you’re able to predict what’s going to happen with the coronavirus or what’s going to happen with the (presidential) election or what will happen with interest rates, we feel a lot of those things are unpredictable and might not even tell you where the market is going,” Baron said. “We spend all of our time focusing on companies, and that is where we can add value for our clients.”

Many funds talk about diversification in terms of sector exposure. But Baron Partners looks at its asset mix through the prism of the types of stocks it holds. For starters the portfolio has disruptive growth companies like Tesla. Then there’s steady core growth investments like business advisory IT company **Gartner**[®]. It’s got real and irreplaceable assets like Hyatt Hotels and Vail Resorts. Finally it includes financial companies like FactSet. This mix of companies all work together to provide portfolio diversification.

“When you deal with a concentrated fund, what’s important is that not all companies act the same,” Baron said. The fund’s beta, which is a measure of fund risk vs. its benchmark, is

just 1.06 — or just slightly greater than the S&P 500, which has a beta of 1.0, he said.

The fund typically uses 20% to 30% leverage, which means that for every \$100 in assets under management, it will borrow \$20 to \$30 more to invest in securities. That additional buying power can boost returns when stocks are rising but can weigh on performance in falling markets.

Baron says his fund reduces leverage in times of market turbulence, but not in a big way. “We typically don’t change it drastically,” Baron said.

More than half (52.4%) of this best growth mutual fund’s assets as of Dec. 31, 2019, were invested in “disruptive growth” companies. These companies are “going to revolutionize their industries” and take on incumbents, said Baron.

The best example, he said, is Tesla, the fund’s second-largest holding at the end of 2019. Tesla is the leader in the electric car race. And Baron Partners Fund thinks that as Tesla opens more production facilities in places like China and Europe, it is poised for rapid growth and a lot more cars in the future, cementing its leadership in the space.

“We anticipate Tesla sales growing 50% this year to 540,000 vehicles,” Baron told IBD. “They should be able to continue on a high vehicle growth trajectory over the next decade due to increased number of popular models and efficient production at factories around the world. By 2030, they could produce 10 million vehicles, more than 2 million in China alone. These vehicles can generate \$500 billion in revenue. An additional \$250 billion to \$500 billion in revenue can come from the energy business, at which point the company could

be valued at \$1 trillion to \$1.5 trillion. Today’s market cap is approximately \$150 billion.”

But the fund’s co-manager isn’t expecting all the sales to come overnight, nor is he trying to predict when its new China factory will be again running at full capacity. That’s because the bet on Tesla is a multiyear one. What the fund focuses on, he said, isn’t short-term Tesla stock price fluctuations or the unpredictable impact of the coronavirus on sales in the short run.

All the focus is on the underlying strength of Tesla’s business. “They still have a lot more room to grow,” Baron said. “They’re nowhere close to being done.”

Another “disrupter” in this best growth mutual fund’s portfolio is Zillow, the online real estate site that’s leveraging its massive database of real estate sales statistics. “The idea around Zillow is that it should be just as easy to buy a home online and digitally than it is to buy any other consumer product,” Baron said.

Zillow is rewriting the book on how houses are bought and sold. That includes how they’re marketed by real estate agents in the digital world, Baron said. Zillow’s database gives it an informational edge. It enables agents to boost their sales success rates. That in turn allows Zillow to receive a higher fee for the leads they generate that result in sales.

“They are able to participate in the commission on the home sale,” Baron said. Zillow is also using its informational edge on pricing to get into the buying and selling of homes via a new concept known as iBuying. In this process, Zillow uses its price data to appraise the value of homes, then makes direct bids to purchase the homes from potential sellers. “They’re

willing to be a buyer of last resort and turn around and sell it to someone else and make a profit,” Baron said. “They’re revolutionizing the way homes are sold in this country.”

Most investors know what a stock in the tech or health sector is all about. But what exactly is a real/irreplaceable asset?

A good example is Vail Resorts, the outdoor mountain resort company that caters to skiers and snowboarders, and profits on the use of the land it owns by outdoor enthusiasts.

“You can’t build another mountain,” Baron said. The company’s flagship holding, Vail Resort, located at Vail mountain in Colorado, is arguably the best mountain for skiing, he said. But Vail also owns the greatest number of mountains after spending the past few years acquiring other mountains around the country.

Diversifying its outdoor sporting and entertainment product to more mountains means it can sell its season passes “to a greater number of people.” That allows the company to take advantage of this fixed asset with fixed costs, Baron said. The company’s strategy of raising prices for daily lift tickets is also seen boosting revenue. “We feel they should be able to increase the number of people using their resorts and get a higher price per person,” Baron said.

Baron Partners’ unique approach of concentrating its bets and using leverage to enhance returns and build wealth over the long-haul isn’t for every investor.

“The fund is best-suited for people that line up with our longtime horizon,” Baron said. “So if you need the money tomorrow, or if you are trying to make a quick investment and get in and out, then, no, this fund doesn’t work for this type of investor.”

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Baron Partners Fund's annualized returns for the Institutional Shares as of March 31, 2020: 1-year, (1.30)%; 5-years, 8.18%; 10-years, 12.65%; Since Inception (1/31/1992), 12.34%. Annual expense ratio for the Institutional Shares as of December 31, 2018 was 1.77% (comprised of operating expenses of 1.06% and interest expense of 0.71%). The Fund's annualized returns for the Retail Shares as of March 31, 2020: 1-year, (1.56)%; 5-years, 7.89%; 10-years, 12.34%; Since Inception (1/31/1992), 12.22%. Annual expense ratio for the Retail Shares as of December 31, 2018 was 2.03% (comprised of operating expenses of 1.32% and interest expense of 0.71%).

S&P 500 Index's annualized returns as of March 31, 2020: 1-year, (6.98)%; 5-years, 6.73%; 10-years, 10.53%; Since Fund Inception (1/31/1992), 8.95%. **Russell Midcap Growth Index's** annualized returns as of March 31, 2020: 1-year, (9.45)%; 5-years, 5.61%; 10-years, 10.89%; Since Inception (1/31/1992), 9.09%.

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.

Reflects the actual fees and expenses that were charged when the Fund was a partnership. The predecessor partnership charged a 20% performance fee after reaching a certain performance benchmark. If the annual returns for the Fund did not reflect the performance fees the returns would be higher. The Fund's shareholders will not be charged a performance fee. The predecessor partnership's performance is only for periods before the Fund's registration statement was effective, which was April 30, 2003. During those periods, the predecessor partnership was not registered under the Investment Company Act of 1940 and was not subject to its requirements or the requirements of the Internal Revenue Code relating to registered investment companies, which, if it were, might have adversely affected its performance.

Performance for the Institutional Shares prior to 5/29/2009 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 5/29/2009 did not reflect this fee, the returns would be higher.

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Risks: The Adviser believes that there is more potential for capital appreciation using non-diversification and leverage, but there also is more risk. Specific risks associated with non-diversification and leverage include increased volatility of the Fund's returns and exposure of the Fund to greater loss in any given period. The Fund invests in companies of all sizes, including small and medium sized companies whose securities may be thinly traded and made difficult to sell during market downturns. Leverage is the degree to which an investor or business is utilizing borrowed money.

Portfolio holdings as a percentage of total investments as of 12/31/19 for securities mentioned are as follows: **Gartner, Inc.** – 3.7%.

Baron Partners Fund Top 10 Holdings as of December 31, 2019

Holding	% Holding
CoStar Group, Inc.	14.5
Tesla, Inc.	13.3
Arch Capital Group Ltd.	8.5
IDEXX Laboratories, Inc.	6.8
Hyatt Hotels Corp.	6.7
Vail Resorts, Inc.	6.4
FactSet Research Systems, Inc.	6.0
Space Exploration Technologies Corp.	4.1
The Charles Schwab Corp.	4.0
Guidewire Software, Inc.	3.8
Total	74.1

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

The **Russell Midcap™ Growth Index** measures the performance of medium-sized U.S. companies that are classified as growth and the **S&P 500 Index** of 500 widely held large-cap U.S. companies. The Russell Midcap Growth Index, the S&P 500 Index and the Fund are with dividends, which positively impact the performance results. The indexes are unmanaged. Index performance is not fund performance. Investors cannot invest directly in an index.

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