BARON CAPITAL

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Mike Lippert: The COVID-19 pandemic, how we are managing our portfolios, and what the world will look like post-crisis

This is an edited version of a March 27, 2020 Q&A with Mike Lippert, Portfolio Manager of Baron Opportunity Fund. To access the full recording, please dial 866-595-5357, passcode 8152767#.

Key Discussion Points

Current market conditions
General thoughts on the COVID-19 pandemic

Baron Opportunity Fund
Fund performance, management of the portfolio, company-specific performance, Tesla

Market outlook

Current Market Conditions

- ***Could you share your current thinking on the coronavirus pandemic and its impact on the markets and the economy?***

  The market is dealing with something that we've never really faced before. We've had financial crises and sudden crises like 9/11. The world is trying to draw lessons from these past crises, but every new one is somewhat different. So exactly how long this pandemic will last, how deep the economic pain will be, how quickly we will turn the tide toward recovery – I don't know the answers to these questions, nor do I think anyone else does.

  The Federal Reserve is applying the lessons from 2008-2009 to keep the economy and the markets afloat. They're going big and broad and taking measures they haven't taken before. Chairman Powell has announced he will even do more, so that's a positive. The fiscal stimulus bill in Congress is bigger and better than I expected. I don't know whether it will be as much support as needed because it depends on how long the pandemic lasts, but Congress banding together to pass a compromise bill is a positive sign.

  This crisis will only accelerate changes that are already happening in the world. Legacy companies, those that are holding back, can't avoid going where the world is going. That is what happened in 2008-09. And I think that will happen again in this crisis. Every company we have talked to is telling us that digital transformation will be accelerated in their industry, whether they're in media, health care, cybersecurity, content, software, etc.

Baron Opportunity Fund

- ***How has the portfolio performed during the crisis?***

  We've outperformed our benchmark across all major time periods since we launched the Fund in 2000, with particular strength over the last three-to-five-year period. I knew a major test would be how the portfolio would perform in a weak market. I'm very encouraged that one month into this crisis-driven down market, we have performed very well on the downside. The portfolio is down less than 6% year-to-date.

  Although we have made some adjustments like everyone else, I don't believe this is the reason for our strong performance. I believe it's because we are invested in businesses that are benefiting from or driving digital transformation and other innovation-driven themes that are holding up better in the crisis.

We are communicating digitally, our kids are taking classes online, everyone is working at home. I think the themes we emphasize and the companies we invest in will only get stronger, because given what's going on right now, employees, businesses, and consumers are changing the way they live and work.

- ***How are you managing the portfolio in response?***

As long-term investors, we want to own the companies that have the competitive advantages, business models, the margins, and the balance sheets to get through this disruption intact. We've made some tactical decisions, selling or reducing our positions in businesses we think will be the hardest hit.

On a qualitative basis, we try to determine how businesses will be impacted and to what degree. Subscription-type businesses and other businesses with critical products and services have held up well. E-commerce businesses and home entertainment are gaining strength.

On a quantitative basis, we look for any liquidity issues, because any time you have massive weakness in the economy, you strain the financial system. I typically avoid companies carrying a lot of debt, so that is a minor percentage of the portfolio. We are looking at worst-case operating and liquidity scenarios with every company we own. Finally, we are re-assessing price targets (and ranges) using more conservative numbers – both financial projections and multiples – than we had going into the crisis. But I would like to stress that our focus is not on the next six-month or even year-long period. We are looking two-to-three years out.

These exercises help us make pragmatic, fact-based decisions and remove any emotion from the analysis. We don't want to make decisions based on hope or fear. Where we can project with confidence what these businesses will do during and after the crisis and find attractive opportunities based on our conservative valuation work, that’s when we're adding. Some are established winners that have come down in price. Others are up-and-comers – next generation winners.

- ***How have companies in the portfolio been performing?***

Some stocks in the portfolio have held up relatively well. Others have gotten hit although we think they will emerge from this crisis stronger. With valuations substantially down from where they were, it is a great opportunity to improve the quality of the portfolio and position it for what we think the world post-crisis is going to look like.

The stock of Zoom Video Communications, Inc., which offers face-to-face video conferencing, is at all-time highs. We've owned Zoom since the IPO. It has a freemium model so a lot of the usage now is free, but they have trip wires where users must pay to extend calls beyond a certain length of time or number of participants. The business was up 88% last year. I would not be surprised if it doubles this year. CrowdStrike, Inc., an end-point cybersecurity company which again we've owned since the IPO, should also benefit from the crisis given the increase in the number of people working remotely.

We are also seeing strength in e-commerce like Amazon.com, Inc. since no one can go to stores right now. Internet-based entertainment subscription services like Netflix, Inc. should benefit as well. Certain areas of Health Care will certainly gain strength, including all forms of diagnostic and genetics testing. Electronic payments, including credit cards like Mastercard Incorporated and Visa, Inc. and mobile payment services like PayPal Holdings, Inc. and Venmo (which is owned by PayPal), are gaining strength.

I think every one of the secular trends we've invested in will be strengthened by this disruption. We are talking to senior management of as many of our companies as we can, and it’s no exaggeration that every management team we’ve talked to believes they're going to be stronger coming out of this.

- ***Certainly there are some industries and businesses you typically don’t invest in that seem oversold at this time. Are you tempted to take advantage of the fire sales you are seeing in the markets right now?***

I won't dismiss that there will be a short-term bounce in companies that are getting whacked, whether it's travel and hotels, certain areas of retail, restaurants, etc. But, again, I'm focused on secular innovation-driven trends and sustainable growth, so the answer is no, I won’t be investing in those types of companies.

As the Fund has an all-cap mandate, we can invest in any size company from mega-caps like Microsoft Corporation and Amazon.com, Inc. to up-and-comers that may have market caps as low as $1 billion. We can also look outside the United States. We own Alibaba Group Holding Company Limited, a China-based company that some people describe as Amazon plus PayPal. We also own GDS Holdings Limited, the leading network-neutral data center in China. In our recent conversation with management, they told us that even the state-owned enterprises are realizing they need to convert to digital. So, I think both businesses will be stronger coming out of this.

We're looking for doubles in our investments in four or five years. But we have had businesses that have grown much more than that. This morning, I was talking to the CEO of CoStar Group, Inc., which provides data and marketing services to the real estate industry. He knows the business is going to be impacted during this crisis, but he's also convinced that the business will be strengthened because of its focus on digital marketing, virtual leasing, and data. Our average cost in CoStar Group is less than $34. Even with the pullback, it's a $580 stock today.

- ***Are you going to cash?***

  No. We have been benefiting from positive inflows this year, even in the current environment. We are putting that money to work by investing in companies at what we think are attractive prices. We have ranges where we will add to existing investments and buy ranges on companies that are not in the portfolio.

- ***You were the first portfolio manager at Baron to invest in Tesla, Inc., and it's currently a top five holding in the portfolio. How do you expect the company to hold up in this crisis?***

  Of course, Tesla's business is going to be impacted in the short term. A week and a half ago, it had to close its California plant. We don't know how long it will be closed. But it entered the crisis with $8.5-$9 billion in cash and generating free cash flow. Vehicle production at its new Shanghai plant has resumed. Even though the stock has pulled back from all-time highs, I think Tesla's liquidity is helping hold up its price. When we get back to normal, Tesla's business is going to be quite strong, given the trends in the automotive industry – electric vehicles, autonomous driving, ride-sharing networks – each of which Tesla is or will be a leader in. The newly released Model Y is the best car Tesla has ever made. When the world returns to some form of normalcy, I think Tesla will sell them as fast as they can make them.

Market Outlook

I can't predict how long the crisis will go on or exactly what will happen. But we're going to continue investing as we always have in companies that are benefiting from secular growth, innovative, transformational, generational shifts in our economy and industries. All the phone conversations with management and research that I've done during this time only leads me to the conclusion that these trends will be accelerated.

Investors have to do what they have to do. But I know from my experience during the 2008-09 financial crisis that investors who pull out during a crisis oftentimes get back into the market too late. Unless you need the money right now, I think you should stay in the market. And you want to push your investments toward the companies and investment management firms that you think have the right focus, not only in this environment, but on where the world's going to be coming out of it. So that's what we're trying to do and be for our clients.

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

Baron Opportunity Fund's annualized returns for the Institutional Shares as of March 31, 2020: 1-year, 8.11%; 5-years, 13.26%; 10-years, 13.00%; Since Inception (2/29/2000), 7.31%. Annual expense ratio for the Institutional Shares as of September 30, 2019 was 1.09%. The **Russell 3000 Growth Index**'s annualized returns as of March 31, 2020: 1-year, (0.44)%; 5-years, 9.74%; 10-years, 12.68%; Since Fund Inception (2/29/2000), 4.27%.

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.

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.

Risks: The Adviser believes that there is more potential for capital appreciation in securities of high growth businesses benefiting from innovation through development of pioneering, transformative or technologically advanced products or services, but there also is more risk. Companies propelled by innovation, including technological advances and new business models, may present the risk of rapid change and product obsolescence and their successes may be difficult to predict for the long term. Securities issued by small and medium sized companies may be thinly traded and 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 discussion of market trends is not intended as advice to any person regarding the advisability of investing in any particular security. The views expressed in this document reflect those of the respective writer. Some of our comments are based on management expectations and are considered "forward-looking statements." Actual future results, however, may prove to be different from our expectations. Our views are a reflection of our best judgment at the time and are subject to change at any time based on market and other conditions and Baron has no obligation to update them.

As of 12/31/19, the **Morningstar US Fund Large Growth Category** consisted of 1,218, 1,086, 811, and 1,218 share classes for the 3-year, 5-year, 10-year, and overall periods. Morningstar has awarded **Baron Opportunity Fund Institutional** Share Class 5 stars, 4 stars, 3 stars, and 4 stars for its 3-year, 5-year, 10-year, and overall performance, respectively.

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 three-year period actually has the greatest impact because it is included in all three rating periods.

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Portfolio holdings as a percentage of net assets as of December 31, 2019 for securities mentioned are as follows: **Zoom Video Communications, Inc.** – 0.5%; **CrowdStrike, Inc.** – 0.3%; **Amazon.com, Inc.** – 6.3%; **Netflix, Inc.** – 1.3%; **Mastercard Incorporated** – 2.3%; **Visa, Inc.** – 2.2%; **PayPal Holdings, Inc.** – 0.7%; **Microsoft Corporation** – 7.3%; **Alibaba Group Holding Company Limited** – 2.2%; **GDS Holdings Limited** – 1.6%; **CoStar Group, Inc.** – 2.4%; **Tesla, Inc.** – 4.3%.

Top 10 holdings as of December 31, 2019

Holding	% Assets
Microsoft Corporation	7.3
Amazon.com, Inc.	6.3
Alphabet Inc.	4.7
Tesla, Inc.	4.3
Guidewire Software, Inc.	3.9
Gartner, Inc.	3.2
Trainline Plc	2.5
argenx SE	2.5
CoStar Group, Inc.	2.4
Mastercard Incorporated	2.3
Total	39.4

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

The Russell 3000® Growth Index measures the performance of the broad growth segment of the U.S. equity universe comprised of the largest 3000 U.S. companies representing approximately 98% of the investable U.S. equity market, the **S&P 500 Index** of 500 widely held large-cap U.S. companies. The indexes and the Fund are with dividends, which positively impact the performance results. 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. Index performance is not fund performance. Investors cannot invest directly in an index.

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