



## Ron, Michael, and David Baron: Growth Investing in the Current Environment

This is an edited version of a May 5, 2022, Q&A with Ron Baron, Michael Baron, and David Baron. Ron is CEO of Baron Capital and portfolio manager of Baron Partners Fund and Baron Focused Growth Fund, among others. Michael is portfolio manager of Baron Partners Fund as well as Baron WealthBuilder Fund. David is portfolio manager of Baron Focused Growth Fund. To access the full recording, please visit [our website](#).

### Executive Summary

- Historically, stock valuations have been more likely to rise than fall when rates are increasing from low levels, as they are today. In our view, periods of extreme uncertainty, like now, are not the time to run away from investing in stocks.
- The majority of our holdings are not seeing declines in their businesses, and consumer demand remains robust across many industries. We believe many are coming out of this pandemic in a stronger position than when they went into it.
- We continue to see investment opportunities. The correction has created an opening to buy stock in companies we like at what we believe are attractive prices.
- We invest in companies that constantly invest in themselves no matter the market environment. We believe earnings growth should more than offset any additional contraction in multiples.
- We don't know how this short-term market volatility will play out, how long it will last, or when this rotation will end. We are confident it will end eventually. The market will return to trading based on company fundamentals rather than sentiment.

### *In times like this, when the investment landscape is volatile, what gives you and the other Baron portfolio managers the confidence to stay the course?*

**Ron Baron:** Inflation is always present. Historically, the value of money decreases by about half every 14 years. Investing in businesses through the stock market has always been a way to offset that depreciation. I would also point out that, whenever the government has taken aggressive steps to reduce inflation by raising rates from low levels, like today, stock valuations have been more likely to rise than fall. I was just telling a friend I would do as much as I could to not sell any stocks right now. Everything is going to be twice as expensive in 14 years, while, on average, stocks will be worth four times what they are today in 10 or 12 years. Try to hang in there if you can. In our view, periods of extreme uncertainty, like now, are not the time to run away from investing in stocks.

### *Let's talk about Baron Focus Growth Fund. Last quarter you felt positive about your companies. Is that still the case?*

**David Baron:** We know everyone is concerned the Fed will aggressively raise rates to combat inflation, which could potentially drive us into recession. So far, our companies are not seeing weakness in their businesses, and consumer demand remains robust across many industries. Many are emerging from the pandemic stronger than their pre-pandemic position. Earnings and cash flow are rebounding, which they are using to fund growth opportunities, buy back stock, and increase dividends. Companies have positive outlooks and see value in their stocks. Consumers built up an estimated \$2 trillion in savings over the past two years. Combine that with \$2 trillion in private equity capital ready to be deployed, and in our view, you have a supportive environment for stocks.

For example, **Boyd Gaming Corporation** and **MGM Resorts International** reported strong earnings and robust demand and accelerated share buybacks. **Tesla, Inc.** reported strong results despite supply chain issues and COVID-related shutdowns in China. It expects deliveries to accelerate by up to 60% above last year's levels, higher than its immediate-term target of 50% annual growth. Consumer demand should support further growth as electric vehicles comprise just 2% of the total addressable market. Tesla's gross margins are in the low 30% range despite cost pressure and high-teens operating margins. Its 40% EBITDA cash conversions are unheard of for a car company, and it has a strong balance sheet with \$18 billion in cash and just \$100 million of debt. Suffice it to say we still see significant upside.

The correction created a chance to buy or add to stock in companies we like at attractive prices. For example, **MSCI, Inc.** was down 10% on worries about its fee-based business and stock market declines. While this represents 25% of its business, its core business continues to grow quickly with organic revenue growth in the mid-teens, recurring subscription revenue growth in the high-teens, new subscription sales up 2%, and a retention rate of 96%. The company generates a lot of cash, which it is using for share buybacks. It sees value in its stock, and we agree. We've added to our position.

Shares of digital music service **Spotify Technology SA** were down on controversy around Joe Rogan's podcasts along with broader macro concerns. We view Spotify as a long-term winner in audio streaming with potential to reach more than a billion users and bought more shares on the dip.

Shares of **Krispy Kreme, Inc.** fell on supply chain issues including increased transportation costs as well as high-impact costs. We added to shares as we think these costs are being offset by higher pricing, and the company is adding new stores at a double-digit rate, continues to improve margins, and has a large addressable market with a strong brand that should allow it to continue to take share.

Travel and leisure stocks, which now comprise over 20% of the Fund, are seeing performance above pre-pandemic levels driven by lower marketing and labor costs and a higher-income consumer. With improved balance sheets and cash flows we see potential for growth in many of these names.

We invest in companies that constantly invest in themselves regardless of the market, and as a result, we believe they can continue to grow in an inflationary environment. I don't have a crystal ball, but we believe earnings growth will more than offset any additional multiple contraction from higher rates.

***Let's move on to Baron Partners Fund.***

**Michael Baron:** It has been a tough macro environment for growth investors, but the Fund is doing better than many of our peers and the index on an absolute and relative basis. From a fundamental standpoint, a lot of the companies we speak to are reporting good numbers and saying that business fundamentals remain strong and their goals attainable.

The current rotation has not favored growth companies or our style of investing. Inflation and interest rates, supply chain concerns, labor shortages, and the invasion of Ukraine have hurt growth investors by causing higher discounting of future revenue streams and more expensive financing for initiatives. It's become harder for these businesses to take on entrenched incumbents. It's more expensive to operate.

And Russia's invasion of Ukraine has called into question the notion of a more global economy. But we're not changing what we do or how we do it. That's what's we think drove our strong results.

*If you are not changing what we do, is there anything you can do to combat interest rate inflation?*

**Michael Baron:** We're not changing the strategy. It's concentrated; top 10 positions account for 93.6% of assets. It uses leverage. Currently leverage stands at 10.8%, up slightly from last quarter but down significantly from its historical average. I think we've done a good job finding businesses that act differently from one another in the same environment. We think that strategy has helped us retain value in this difficult quarter.

Companies like Tesla, **Space Exploration Technologies Corp. ("SpaceX")**, and **Iridium Communications Inc.** are disruptive businesses that have all grown in this challenging environment. Tesla grew more than 60% in the most recent quarter, delivering 310,000 vehicles. While other car companies grappled with supply chain and labor shortages, Tesla's more vertical integration helped to insulate it from these shortages, allowing it to continue to grow.

SpaceX is another large holding in the Fund. It now has 20% more satellites in orbit than at the start of the year. After Russia's invasion of Ukraine, SpaceX provided Ukraine with 5,000 terminals to help its citizens stay informed and maintain communication. The company delivered these terminals free of charge and quickly disseminated and set them up.

Disruptive businesses are not the only ones driving performance. Our financial and real asset holdings also retained value during the rotation. While fintech names such as MSCI and **FactSet Research Systems, Inc.** have been under more pressure, a lot of our financials like **Arch Capital Group, Ltd.** and **The Charles Schwab Corp.** have held up well. Arch Capital is seeing firmer property & casualty insurance pricing. It can lean in more there while others have been pulling back. In prior periods, it relied more on its mortgage insurance business. Now it is being more aggressive in writing policies with higher rates. With over \$600 billion on its balance sheet, Schwab has benefited from the higher rate environment.

We've seen more pressure on our core growth businesses even though their fundamentals are strong. **CoStar Group, Inc.**, **IDEXX Laboratories, Inc.**, and **Gartner Inc.** are examples. All three have built out their sales teams, which should provide a tailwind going forward.

Other names that have lost ground while their fundamentals remain solid include Spotify and **Shopify Inc.** Both are leaders in their markets. Spotify dominates the digital audio market. In addition to its core music offering, it's making significant inroads in spoken-word content like podcasts and audiobooks, a higher-margin business with more ad revenue and lower fees. While it will take time to build out that business, we are confident it will. Shopify has been investing in its services levels to help bring it up to par with what **Amazon.com, Inc.** offers its customers. If it is successful in doing so in its space -- branded services and products -- we think it will grow its customer base and even charge more for its services.

*Do you have any thoughts where this market is going? How do you maintain confidence?*

**Michael Baron:** While we don't know how long this volatility will persist or when the rotation will end, we are confident it will end eventually, and investors will go back to trading based on company fundamentals rather than sentiment. In the two periods when the market faced significant headwinds, the collapse of the internet bubble and the financial panic, the Fund retained value. We believe it's the way we structure the portfolio that allows us to weather these type environments.

*I would be remiss if I didn't ask about Elon Musk's Twitter purchase, given your investments in SpaceX and Tesla.*

**Ron Baron:** We are likely to invest in **Twitter Inc.** We were skeptical initially, but after quite a bit of research, we think the business is substantially differentiated from other social media. It's a town square where people can engage in conversation and debate whatever is happening or the current news or find information on anything and talk to experts. It's the only place where content providers can really engage with and have a conversation with a follower.

We think the business has been poorly run. After Elon selects a new management team, the opportunities seem almost limitless. First, Twitter has 10 times the number of engineers than are probably necessary. Second, it spends a great deal on sales and marketing -- 18% to 20% of revenues. Third, no revenue flows to content providers.

What Elon does is assess every level of a business. He always believes a business can be run with far fewer people if those people are smart and work hard. Twitter's employees haven't had that reputation, and the business has grown only modestly. But it does have 200 million subscribers and followers. The goal is to get to a billion subscribers in five years and, at the same time, reduce costs to achieve more revenue per user. I think right now Facebook derives about 10 times the amount of revenue on its content as Twitter. So, we see a big opportunity to achieve more revenue at a much lower cost. That makes the company a lot more interesting. The company is going to go private and could potentially go public again some five or six years in the future.

***Do you have any insight into how much Elon Musk will be actively involved in Twitter?***

**Ron Baron:** After the first several months it's probably not going to be as much as you might think. I expect he will focus on selecting a management team and hiring engineers. He's going to tell them, "This is what you need to do, this is what you need to develop, and you need to make it a much simpler system." Then I think he will pull back and go back to his normal day jobs.

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*Investors should consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus and summary prospectuses contain this and other information about the funds. You may obtain them by calling the fund's distributor, Baron Capital at 1-800-99BARON, or by visiting [www.baronfunds.com](http://www.baronfunds.com). Please read them carefully before investing.*

**Baron Focused Growth Fund's** annualized returns for the Institutional Shares as of March 31, 2022: 1-year 9.47%, 5-year 31.02%, 10-year 19.00%. Annual expense ratio for the Institutional Shares as of December 31, 2021, was 1.05%. The **Russell 2500 Growth Index's** annualized returns as of March 31, 2022: 1-year -10.12%, 5-year 13.22%, 10-year 12.69%.

**Baron Partners Fund's** annualized returns for the Institutional Shares as of March 31, 2022: 1-year 24.51%, 5-year 39.02%, 10-year 25.80%. Annual expense ratio for the Institutional Shares as of December 31, 2021, was 1.11% (comprised of operating expenses of 1.05% and interest expense of 0.06%). The **Russell MidCap Growth Index's** annualized returns as of March 31, 2022: 1-year -0.89%, 5-year 15.10%, 10-year 13.52%.

*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, 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](http://www.BaronFunds.com) or call 1-800-99BARON.*

Performance reflects the actual fees and expenses that were charged when the Funds were partnerships. The predecessor partnerships charged a 20% performance fee (**Baron Partners Fund**) or a 15% performance fee (**Baron Focused Growth Fund**) after reaching a certain performance benchmark. If the annual returns for the Funds did not reflect the performance fee for the years the predecessor partnerships charged a performance fee, returns would be higher. The Funds' shareholders are not charged a performance fee.

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 Funds are non-diversified which means, in addition to increased volatility of the Funds' returns, they will likely have a greater percentage of their assets in a single issuer or a small number of issuers, including in a particular industry than a diversified fund. Single issuer risk is the possibility that factors specific to an issuer to which the Funds are exposed will affect the market prices of the issuer's securities and therefore the net asset value of the Funds. As of the date of the latest prospectus supplement, about 49% of Baron Partners and 27% of Baron Focused Growth Funds' assets are invested in Tesla stock. Therefore, the Funds are exposed to the risk that were Tesla stock to lose significant value, which could happen rapidly, the Funds' performance would be adversely affected. Specific risks associated with investing in small and medium-sized companies include that the securities may be thinly traded and more difficult to sell during market downturns. The Funds may not achieve their objectives. **Baron Partners Fund:** Special risks associated with leverage include increased volatility of the Fund's returns and exposure of the Fund to greater risk of loss in any given period.

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 presentation reflect those of the respective speaker. 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.

**Portfolio holdings as a percentage of net assets\* as of March 31, 2022, for securities mentioned are as follows:** **Boyd Gaming Corporation**– Baron Focused Growth Fund 1.2%; **MGM Resorts International** – Baron Focused Growth Fund 2.1%; **MSCI, Inc.** – Baron Focused Growth Fund 2.5%, Baron Partners Fund 1.0%; **CoStar Group, Inc.** – Baron Focused Growth Fund 4.9%, Baron Partners Fund 5.5%; **Spotify Technology S.A.** – Baron Focused Growth Fund 3.3%, Baron Partners Fund 2.5%; **Krispy Kreme, Inc.** – Baron Focused Growth Fund 1.8%, Baron Partners Fund 0.2%; **Tesla, Inc.**– Baron Focused Growth Fund 27.7%, Baron Partners Fund 49.0%; **Space Exploration Technologies Corp.** – Baron Focused Growth Fund 8.5%, Baron Partners Fund 5.2%; **FactSet Research Systems** - Baron Focused Growth Fund 4.5%, Baron Partners Fund 3.5%; **Iridium Communications, Inc.** - Baron Focused Growth Fund 3.2%, Baron Partners Fund 1.8%; **Arch Capital Group**- Baron Focused Growth Fund 5.5%, Baron Partners Fund 3.6%; **The Charles Schwab Company** -Baron Partners Fund 3.7%; **IDEXX Laboratories, Inc.** - Baron Partners Fund 4.9%; **Shopify Inc.** - Baron Partners Fund 1.5%; **Gartner, Inc.**- Baron Partners Fund 2.3%.

Neither Baron Focus Growth Fund nor Baron Partners Fund owned **Twitter Inc.** or **Amazon.com Inc.** as of 3/31/2022.

\*Holdings for Baron Partners Fund are expressed as a percentage of long positions.

**Baron Focused Growth Fund Top 10 holdings as of March 31, 2022**

Holding	% Assets
Tesla, Inc.	27.7
Space Exploration Technologies Corp.	8.5
Hyatt Hotels Corp.	6.0
Arch Capital Group Ltd.	5.5
CoStar Group, Inc.	4.9
FactSet Research Systems, Inc	4.5
Vail Resorts Inc.	4.4
Guidewire Software, Inc.	4.2
Spotify Technology S.A.	3.3
Iridium Communications, Inc.	3.2
Total	72.2

**Baron Partners Fund Top 10 holdings as of March 31, 2022**

Holding	% Assets
Tesla, Inc	49.0
CoStar Group, Inc	5.5
Space Exploration Technologies Corp.	5.2
IDEXX Laboratories, Inc.	4.9
The Charles Schwab Corp.	3.7
Hyatt Hotels Corp.	3.6
Arch Capital Group Ltd.	3.6
FactSet Research Systems, Inc	3.5
Vail Resorts, Inc.	3.1
Spotify Technology, S.A.	2.5
Total	84.6

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

Definitions (provided by BAMCO, Inc.): The **Russell 2500™ Growth Index** measures the performance of small to medium-sized U.S. companies that are classified as growth. The **Russell Midcap™ Growth Index** measures the performance of medium-sized U.S. companies that are classified as growth. The **S&P 500 Index** of 500 widely the performance of small to medium-sized U.S. companies that 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. Index performance is not Fund performance; one cannot invest directly into an index.

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