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

This is an edited version of an October 28, 2021, 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. Michael is portfolio manager of Baron Partners Fund. David is portfolio manager of Baron Focused Growth Fund. To access the full recording, please dial 800-633-8284, passcode #2199785.

Key Discussion Points

Baron Focused Growth Fund

- The factors driving continued strong performance
- Why we don't see rising rates as a threat

Baron Partners Fund

- Performance: the benefit of conviction and consistency
- Dispersion of results among the disruptors

Manager discussion

- The key differences between Baron Partners Fund and Baron Focused Growth Fund
- The reasoning behind our sector overweight positions
- China – our exposure and outlook

Introduction

Baron Partners Fund is a focused all-cap fund that invests in growth stocks, while Baron Focused Growth Fund is a smid-cap fund comprised of the highest conviction ideas of its portfolio managers. Both are fairly concentrated: top 10 holdings comprise 79.3% of Baron Partners Fund's total investments by weight and 74.3% of Baron Focused Growth Fund's net assets by weight.

This approach has produced outstanding results for both Funds. Baron Partners Fund ranked in the top 1% of its Morningstar category for the 1-, 3-, 5-, and 10-year periods as of September 30, 2021. Baron Focused Growth Fund ranked in either the top 1% or 2% for the 3-, 5- and 10-year periods and in the top 10% for the 1-year period.

The Morningstar Mid-Cap Growth Category consisted of 584, 549, 495, and 386 share classes for the 1-, 3-, 5-, and 10-year periods.

Morningstar ranked Baron Focused Growth Fund in the 10th, 1st, 2nd, and 1st percentiles for the 1-, 3-, 5-, and 10-year periods, respectively.

The Morningstar Large Growth Category consisted of 1,235, 1,133, 1,024, and 762 share classes for the 1-, 3-, 5-, and 10-year periods. Morningstar ranked Baron Partners Fund in the 1st, 1st,1st, and 1st percentiles for the 1-, 3-, 5-, and 10-year periods, respectively.

Morningstar calculates the Morningstar Large Growth and Mid-Cap Growth Category average performance and rankings using its 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.

Baron Focused Growth Fund

What drove the Fund's strong third quarter performance?

David Baron: The Fund gained 4.86% for the quarter, outperforming its benchmark index by 839 basis points. That outperformance was driven by companies with accelerated revenue growth: **Tesla, Inc., BioNTech SE, Manchester United plc, FactSet Research Systems, Inc.** Together, these names comprise 43% of the portfolio and contributed 732 basis points of outperformance during the quarter.

Tesla, which represents one-third of the portfolio, increased 14% as deliveries and production accelerated sharply. The company benefited from having its own cell manufacturing facility, thus avoiding supply chain issues, and has become a more vertically integrated business.

FactSet, with a weighting of 4% in the portfolio, increased 18% in the quarter. Its revenue growth is accelerating as a result of the introduction of new tools for new and existing clients. We retain conviction in FactSet given its large addressable market, consistent execution on product development and strong financial results.

These increases were slightly offset by declines in companies negatively impacted by the lifting of pandemic restrictions, the potential for increased government scrutiny and regulations in China, or supply chain concerns. For instance, **Spotify Technology S.A.** declined by 19% in the quarter as engagement modestly declined while economies reopened. However, we continue to view Spotify as a long-term beneficiary in music streaming and podcasts. Our other main detractor was **FIGS, Inc.,** a direct-to-consumer brand specializing in uniforms, apparel, and accessories for health care professionals. This stock declined 26% due to supply chain issues, which we believe are transitory and should not impact its long-term growth prospects.

Travel and leisure stocks now comprise a quarter of the portfolio. These investments continue to see strong performance above pre-pandemic levels. They've found better, more efficient ways to operate, allowing them to emerge from the pandemic in a financially stronger position. For instance, **Red Rock Resorts, Inc.,** which had 10 casinos open prior to the pandemic, is now making 90% of its pre-pandemic revenue and almost double its pre-pandemic EBITDA with just six of those 10 casinos open.

As far as purchases and sales during the quarter, we added to our positions in Spotify and **Guidewire Software, Inc.** Both companies have large addressable markets with strong brands that should allow them to take significant market share over time.

We know that investors are concerned with rising rates. This Fund has actually done well in previous periods when rates are increasing. For instance, in 2013 when the 10-year Treasury yield increased from 1.86% to 3%, the Fund increased in value by 26%. In 2018, when the 10-year Treasury yield rose from 2.5% to 3%, the Fund increased 4% while the market declined 4%. Why is this the case? We believe it is because we invest in faster-growing companies that can consistently invest in themselves no matter the market environment. While we don't have a crystal ball, we continue to believe that our companies' earnings growth should be able to more than offset multiple contractions as a result of higher rates.

Baron Partners Fund

Could you walk us through the Fund's performance and provide an update?

Michael Baron: We were up 5.52% for the quarter. Year-to-date, we are up 10.19%, and over the last 12 months we are up 57.43%. So year-to-date we're now slightly ahead of the benchmark, the Russell Mid-Cap Growth Index, which is up 9.60%.

These results followed a really fabulous 2020 when the Fund's returns increased nearly 150%. Clearly, reversion to the mean did not happen. Rebalancing would have been a mistake, not to mention the tax consequences that would have triggered. I think these results demonstrate why it's important to retain conviction during volatile times and have a consistent investment philosophy and process and not change it on a whim. We did not change our philosophy or our process going into COVID, during COVID, or now as we come out of COVID.

Our best performance came from businesses that were able to continue to grow in this environment. Those include Tesla, which had 240,000 deliveries in the quarter, a 73% increase year-over-year. **SpaceX [Space Exploration Technologies Corp.]** also did extremely well. We also had success in biotech, mainly **Moderna, Inc.** and BioNTech, as vaccine acceptance increased along with the number of use cases for vaccine implementation.

However, there has been a dispersion of results among disruptive growth companies. Companies like **RingCentral, Inc.** detracted due to macro concerns. Investors have been concerned about new competitors to RingCentral, yet its growth is at its highest level in over five years. The company has exclusive partnerships with carriers that should allow it to continue this growth and make it a potential acquisition target as well.

Financials and real assets account for around 25% of this portfolio. Higher interest rates have improved cash flow and inflation has made real assets more valuable. **MSCI, Inc.** and FactSet are two great examples on the financial side. Both are increasing their ability to cross sell new products with existing customers.

While our core growth stocks represented our weakest performance, our positions still outpaced the broader market. That's what investing in high-quality growth businesses does. Examples include **Gartner, Inc.**, which is still in its infancy. We believe its total addressable market is 25 times its current level. **Adyen N.V.**, an e-commerce payment facilitator, has improved its growth in all regions. We believe that it will become less reliant on third-party providers in the future, which should also help improve its margins.

However, some companies in core growth did get caught up in macro developments in the quarter. Companies like **GDS Holdings Limited**, a Chinese data provider, and **Activision Blizzard, Inc.**, the gaming provider, were impacted by concerns over new regulations. We own a lot of companies that are significantly below their highs. GDS is one of them. GDS, we believe, is essential for Chinese tech growth and already has a good amount of regulation and oversight. We believe it should be able to navigate from here. It's the same with Activision and Spotify. These names are down around 20% year-to-date. But we're still having gaming growth and it's going to be more integrated throughout our lives. And Spotify has been enhancing its exclusive content which should lower churn.

We remain optimistic. We've had a great quarter and a great year. We still have high conviction in this portfolio going forward.

What differentiates these funds from each other?

Michael Baron: The similarities are obvious. Both are concentrated portfolios with a shared investment philosophy and approach: finding great growth businesses with tremendous opportunities, led by dynamic individuals that we get to know, trust, and respect, and sustainable competitive advantages.

There are three primary differences:

- **Leverage:** Baron Partners Fund can use leverage. Typically, it's 20% to 30%. We brought that down slightly toward the end of 2020 to manage risk, but it's been inching higher, to around 12% today. We expect it to return to its historical level over time.
- **Market cap:** Baron Partners Fund is an all-cap fund but tends to invest in larger cap companies. Sixty-eight percent of the portfolio is currently in large-cap companies. Focused Growth leans a little more to the smaller side, with 60% in small and mid-cap stocks.
- **Sectors:** Both funds invest in disruptive growth, core growth, financials, and real assets. Baron Partners Fund is a bit more balanced between Financial and real assets. Baron Focused Growth is more heavily weighted towards real assets, namely travel and leisure stocks, which are good inflation hedges.

Returns have been strong for both, but there's a little bit of difference in how we achieved it. Baron Partners Fund has a beta of 1.4 while Baron Focused Growth's beta is 1.1. Baron Partners Fund has a higher upside of 175% versus Focused Growth's upside of 143%. But that upside comes with a little bit more risk on the downside: 123% for Partners versus 90% for Focused Growth.

It comes down to what's appropriate for the client. If a client is comfortable with the leverage and investing in slightly larger businesses, Baron Partners Fund may make sense. If a client wants more concentration with lower market caps, a longer runway of growth, and no leverage, then Baron Focused Growth Fund may be the way to go.

Baron Focused Growth Fund has a greater weighting in real assets. What makes you comfortable having so much exposure in this category?

David Baron: We've been investing in the gaming, lodging, and leisure names in the portfolio for quite a while, in some cases since the late '90s. We have a ton of confidence in these names. We know the management teams really well. They have great competitive advantages and growth prospects.

Ron Baron: I would also add that these gaming and leisure stocks and travel companies are reopening the economy. People want to go on vacation again. That's one reason they're doing so well. Number two is that they are inflation hedges.

Baron Partners Fund's largest sector overweight is Financials. What makes this sector attractive?

Michael Baron: A lot of people invest in financials as purely a macro bet – economic growth, interest rates, market movements, and the like. In contrast, our holdings are not a play on interest rates. We are drawn to more dynamic companies like **The Charles Schwab Corp.** Right now, its stock price is fairly well correlated on a short-term basis with interest rates or at least speculation on where interest rates are moving. But what interests us is its ability to attract and retain clients. It is expanding its range of services so it can retain clients throughout their lifecycle. And it's lowering the expense to service them. We see great organic growth, great retention, and great margin potential.

Ron, there's a lot of consternation about the market being overvalued, along with worries about interest rates and inflation. How do these big picture issues tie into your decisions?

Ron Baron: Inflation happens to be something that we believe is ever present, so we don't worry about it. Nor do we worry about politics, the price of oil, or things like Bitcoin. We concern ourselves with the fundamentals of the businesses in which we're investing, not the stock market.

The big advantage we have investing for the long term is that earnings drive stock prices in the short term. We invest in companies that are always investing in themselves. When they do that, they're penalized in current earnings. But they're investing in themselves at the expense of current earnings because they want to become much larger in the future. When companies announce that they're going to grow faster, their stock prices usually they go down because that means that the earnings in the short term are going to be penalized. When they make those kinds of announcements, while others are exiting and the stock price is dropping, we are investing more. We're perfectly willing to accept the fact that we're not going to outperform every single month, every single quarter. We're looking at what the company is going to be worth in five or 10 years.

GDS Holdings, a China-based data center, is held by both funds. How have recent developments in China impacted this investment and what is your outlook?

David Baron: I know everyone's concerned about China right now, given the uncertainty around what the government is going to do. We don't invest based on macro events. We focus on the businesses, their competitive advantages, and their growth opportunities. We think GDS is a perfect example of a company with significant growth opportunities given its vast land bank. Its generating strong returns on its new centers. We still believe China is in the early innings of high adoption. Technology is going to continue to grow in China and that's going to be a big thing for the Chinese government. They're going to want companies like GDS to succeed to help grow the economy.

Both funds own SpaceX as well as Iridium Communications Inc. Can you talk a bit about the difference between SpaceX's Starlink and Iridium Satellite Network?

Ron Baron: The Iridium Satellite Network is for emergency use, for texting around the world in the ocean, the desert, everywhere. In addition, it can locate airplanes wherever they are at any time, which will enable more direct routes, which in turn will save fuel. Iridium is also focused on an explosive business -- the Internet of Things, or IoT. Iridium can track equipment around the world and monitor how it's performing to make sure it remains in operation.

Iridium is a customer of SpaceX. SpaceX's rockets are the cheapest way to get Iridium's satellites into orbit. Historically, the aerospace industry used technology from the 1960s with one-time-use rockets that cost $100 million to $200 million. SpaceX found a way to use a rocket over and over, creating a much cheaper way to access space.

SpaceX also has its own satellite business, Starlink, that will provide fast internet access to anyone, regardless of where they are on the planet. Customers will pay for a user interface, an antenna, and then a monthly fee. That's going to be an enormously profitable business, in our view.

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 Partners Fund's annualized returns for the Institutional Shares as of September 30, 2021: 1-year, 57.43%; 5-years, 38.93%; 10-years, 27.63%; Since Inception (1/31/1992), 16.45%. Annual expense ratio for the Institutional Shares as of December 31, 2020 was 1.30% (comprised of operating expenses of 1.05% and interest expense of 0.25%). The **Russell Midcap Growth Index**'s annualized returns as of

September 30, 2021: 1-year, 30.45%; 5-years, 19.27%; 10-years, 17.54%; Since Fund Inception (1/31/1992), 10.90%.

Baron Focused Growth Fund's annualized returns for the Institutional Shares as of September 30, 2021: 1-year, 42.30%; 5-years, 32.52%; 10-years, 21.40%; Since Inception (5/31/1996), 14.54%. Annual expense ratio for the Institutional Shares as of December 31, 2020 was 1.07%. The **Russell 2500 Growth Index**'s annualized returns as of September 30, 2021: 1-year, 31.98%; 5-years, 18.21%; 10-years, 17.20%; Since Fund Inception (5/31/1996), 9.33%.

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 or call 1-800-99BARON.

Performance for **Baron Partners Fund** 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. The predecessor partnership's performance is only for periods before the Fund's registration statement was effective, which was April 30, 2003. Performance for **Baron Focused Growth Fund** reflects the actual fees and expenses that were charged when the Fund was a partnership. The predecessor partnership charged a 15% performance fee through 2003 after reaching a certain performance benchmark. The performance is only for the periods before the Fund's registration statement was effective, which was June 30, 2008. During these periods, the predecessor partnerships were not registered under the Investment Company Act of 1940 and were 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 their performance. If the annual returns for the Funds did not reflect the performance fees the returns would be higher. The Funds' shareholders will not be 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: **Baron Focused Growth Fund** is non-diversified, which means it will likely have a greater percentage of its 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 Fund is exposed will affect the market prices of the issuer's securities and therefore the net asset value of the Fund. As of the date of the latest prospectus supplement, about 40% of the Fund's assets are invested in Tesla stock. Therefore, the Fund is exposed to the risk that were Tesla stock to lose significant value, which could happen rapidly, the Fund's performance would be adversely affected. **Baron Partners Fund** is non-diversified, which means it will likely have a greater percentage of its 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 Fund is exposed will affect the market prices of the issuer's securities and therefore the net asset value of the Fund. As of the date of the latest prospectus supplement, about 40% of the Fund's assets are invested in Tesla stock. Therefore, the Fund is exposed to the risk that were Tesla stock to lose significant value, which could happen rapidly, the Fund's performance would be adversely affected. Specific 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.

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Portfolio holdings as a percentage of net assets as of September 30, 2021 for securities mentioned are as follows: **Tesla, Inc.** - Baron Partners Fund (40.5%*), Baron Focused Growth Fund (33.4%); **BioNTech SE** – Baron Partners Fund (0.2%*), Baron Focused Growth Fund (2.5%); **Manchester United plc** - Baron Partners Fund (1.2%*), Baron Focused Growth Fund (2.9%); **FactSet Research Systems, Inc.** - Baron Partners Fund (3.5%*), Baron Focused Growth Fund (4.0%); **Spotify Technology S.A.** - Baron Partners Fund (2.3%*), Baron Focused Growth Fund (3.9%); **Red Rock Resorts, Inc.** - Baron Partners Fund (0.4%*), Baron Focused Growth Fund (1.7%); **Guidewire Software, Inc.** - Baron Partners Fund (1.4%*), Baron Focused Growth Fund (2.9%); **Space Exploration Technologies Corp.** - Baron Partners Fund (4.2%*), Baron Focused Growth Fund (3.6%); **RingCentral, Inc.** - Baron Partners Fund (0.9%*); **MSCI, Inc.** - Baron Partners Fund (1.1%*); **Gartner, Inc.** - Baron Partners Fund (2.7%*); **Adyen N.V.** – Baron Partners Fund (2.1%*), Baron Focused Growth Fund (2.2%); **GDS Holdings Limited** – Baron Partners Fund (0.3%*), Baron Focused Growth Fund (1.5%); **Activision Blizzard** - Baron Partners Fund (0.8%*); **The Charles Schwab Corp.** - Baron Partners Fund (3.5%*); **Iridium Communications Inc.** - Baron Partners Fund (0.8%*), Baron Focused Growth Fund (2.1%).

*% of Long Positions.

Top 10 holdings as of September 30, 2021
Baron Partners Fund

Holding	% Assets
Tesla, Inc.	40.5
CoStar Group, Inc.	7.9
IDEXX Laboratories, Inc.	6.2
Space Exploration Technologies Corp.	4.2
Vail Resorts, Inc.	4.2
The Charles Schwab Corp.	3.5
FactSet Research Systems, Inc.	3.5
Hyatt Hotels Corp.	3.2
Arch Capital Group Ltd.	3.1
Zillow Group, Inc.	3.0
Total	79.3
Long Equity Exposure	111.9
Cash & Equivalents	-11.9

Baron Focused Growth Fund	
Holding	**% Assets**
Tesla, Inc.	33.4
CoStar Group, Inc.	7.2
Vail Resorts, Inc.	6.0
Penn National Gaming, Inc.	5.5
Hyatt Hotels Corp.	4.7
FactSet Research Systems, Inc.	4.0
Spotify Technology S.A.	3.9
Space Exploration Technologies Corp.	3.6
Arch Capital Group Ltd.	3.1
Guidewire Software, Inc.	2.9
Total	74.3

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. The **Russell 2500® Growth Index** measures the performance of small to medium-sized U.S. companies that are classified as growth. 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. The index performance is not Fund performance; one cannot invest directly into an index.

Non-mutual fund products are available to institutional investors only.

Beta measures a fund's sensitivity to market movements. The beta of the market is 1.00 by definition. **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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