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

This is an edited version of a March 1, 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 dial 877-325-3876, passcode #22015480.

Executive Summary

- Most of our companies reported strong rebounds in earnings and cash flow and are coming out of this pandemic in stronger positions than when they went into it. Many are using cash flow to fund growth opportunities, buy back stock, and increase dividends — all indicators that they are positive on their outlook and their businesses.
- We view the recent correction as a chance to buy or add to stocks with great growth opportunities at what we view as attractive prices.
- We believe the earnings growth of our companies will more than offset multiple contraction if we see higher rates going forward.
- We believe that diversification within these two concentrated portfolios explains their strong performance in both 2020 and 2021. We think it should continue to serve us well as we navigate the challenges of the current environment.

Ron, let's start with your perspective on this volatile market environment.

Ron Baron: Overall, we remain optimistic. We normally don't give much thought to short-term macro issues like inflation, oil prices, interest rates, and the Russia/Ukraine conflict. Inflation is always with us, yet most people don't speak of it. In my lifetime, inflation has averaged about 4% to 5% a year. That means prices approximately double every 14 or 15 years. The stock market doubles roughly every 10 or 12 years, or about 7% to 8% per year. We try to invest in high-growth companies that, over time, can outpace the growth of the economy and the overall market. To accomplish that goal, we identify competitively advantaged companies with great management teams and invest in them for the long term. This year, with the concern about rising interest rates, the stock prices of these companies have been more adversely affected. To us, that represents a tremendous investment opportunity.

David, please review Baron Focused Growth Fund's performance.

David Baron: In 2021, the Fund was up 19% while our benchmark, the Russell 2500 Growth Index, was up 5.04%. We have consistently outperformed the index since launching the Fund on May 31, 1996. Our average annual returns from inception through 12/31/2021 are 14.85%, vs. 9.25% for the index.

What are you hearing from the companies in your portfolio?

David Baron: We recently finished fourth quarter earnings calls, with companies giving their outlooks for this year. What we're hearing is quite positive. Most reported strong rebounds in earnings and cash flow and appear to be coming out of this pandemic in a stronger position than when they went into it. Many are using cash flow to fund growth opportunities, buy back stocks, and increase dividends — all indicators that they are positive on their outlook and their businesses and see value in their stocks. The updates indicated that the consumer is still strong with an estimated $2 trillion of savings. Combine that amount with $2 trillion of private equity capital waiting to be invested, and we believe this is a supportive environment for stocks.

Hyatt Hotels Corp. and **Choice Hotels International, Inc.** reported strong earnings and demand, especially on the leisure side. Choice raised its dividend above pre-pandemic levels and said it would resume share buybacks this year. **Penn National Gaming**, **Inc.** reported strong earnings as well. Its guidance for 2022 EBITDA for its casinos is about 20% above pre-pandemic levels, which should generate strong cash flow for investing in its online sports betting and iCasino gaming businesses. It also initiated a buyback program for 8% of its stock. We believe it should be able to complete that program over the next 18 months while still investing in additional growth opportunities.

CoStar Group, Inc. stock was down as much as 20% after it reported it was increasing its investment in its residential business at a much higher figure than Wall Street estimates. But management believes the residential business could generate as much as $1 billion of revenue over the next two years and scale from there. CoStar already generates $2 billion of revenue, so you're talking about a 50% increase in revenue just from residential. The company has 40% EBITDA margins and significant free cash flow, so we see much potential for growth and believe the opportunity is not reflected in the stock price.

Does the current market turbulence influence your process or outlook?

David Baron: We see the recent correction as a chance to buy or add to stocks with great growth opportunities at what we believe to be attractive prices.

Spotify Technology S.A. is a good example. Despite a dip in engagement, the company remains a leader in music streaming and podcasts. We believe it has the potential to increase subscribers by 50% over the next three years, driven by its scalable core music product and growing podcast library.

Shares of **Figs Inc.,** a leading direct-to-consumer brand specializing in apparel for health care professionals, declined significantly over concerns about supply chain issues, increased awareness costs, and higher input costs. We added to our position because we believe these issues are transitory. Figs has a large, successful market and strong, unaided brand awareness, and we think it will increase its margins and cash flow as it scales. The co-CEOs own over 15% of the stock, so we believe their interests are aligned with ours as shareholders.

Travel and leisure stocks, which comprise 1/4 of the portfolio, continue to see performance above pre-pandemic levels driven by marketing and labor cost efficiencies as well as a higher income consumer. We think these gains are sustainable and should help these companies improve balance sheets and cash flow. We see growth potential in return of capital in many of these names going forward.

How do you position the portfolio for a rising interest rate environment?

David Baron: I know many investors are concerned about rising rates and the risk of underperformance in this kind of environment. In previous periods of rising rates, the Fund has done well. For instance, in 2013, when the 10-year Treasury went from 1.86% to 3.04%, the Fund returned 26%. In 2018, when the 10-year Treasury went from 2.46% to 3%, the Fund increased 4% while the market declined 4%. Why was this the case? We believe it's because we invest in faster-growing companies that constantly invest in themselves no matter the market environment, which positions them for continued growth in any type of market. While we don't have a crystal ball, we believe the earnings growth of our companies should be able to more than offset multiple contraction if we see higher rates going forward.

Michael, please walk us through Baron Partners Fund's 2021 performance.

Michael Baron: For the full year, the Fund was up 31.73%, comparing very favorably to the index, which gained 12.73%. Of course, we are proud of that — especially in the context of what happened in 2020 when we were up 149%. We not only protected that gain; we built on it. And we outpaced our index in the process, despite an increasingly volatile environment that's continuing into 2022.

How can one portfolio perform so well in two drastically different environments? Baron Partners Fund, like Baron Focused Growth Fund, is a concentrated fund. It's 34 investments. The top 10 account for about 89% of total net assets, and the Fund uses a little bit of leverage at 6.5%. The reason is simple: even though the portfolio is concentrated, it is quite diverse.

How do you diversify within the parameters of a highly concentrated portfolio?

Michael Baron: We seek compelling high-growth companies across a broad spectrum of sectors and themes. For example, disruptive growth is our largest category, representing around 62% of the portfolio. Lately, this area of the market has been heavily targeted by short-sellers and has lost ground in the rotation in investor sentiment toward more conservative, value-oriented companies. Concentration actually helps us here. While disruptive growth companies represent 62% of the portfolio, it's only 10 names, with six positions each comprising 1% or more of total assets. Five of those six appreciated in the quarter. That means we're getting our high-conviction names right. Our two largest holdings in this segment, Tesla and SpaceX, each gained over 30% in this quarter.

Tesla, Inc. is a large position in the Fund. It's important to note that we have not purchased Tesla since 2016. We have trimming our position over the past two years, not because of lower conviction, but because of appreciation and portfolio and risk management. We actually have more conviction in Tesla's business prospects today than we did when we made our last purchase.

What drove its fourth quarter gains? The company delivered more than 300,000 vehicles at 71% growth, despite supply chain issues and labor shortages. Tesla was able to grow 71% because of a decision it made years ago to vertically integrate. It did not want to be reliant on supply chains, which was the historical way of doing business. As a result, not only was Tesla able to grow its top line, but it also showed significant margin improvement, with 30% gross margins and 20% EBITDA margins. These margins are three times higher than those of competitors. They should allow Tesla to introduce a less expensive product in the not-too-distant future. We think no one will be able to compete from a performance or pricing standpoint.

Space Exploration Technologies Corp. (SpaceX) was recently in the news after it sought to help Ukraine through its satellites, communications, and Internet access information flow. In the past quarter, the Falcon 9 reached orbit 11 times, bringing its cost-per-launch down to an unrivaled level. Its Starship should launch in the first half of 2022, and it is introducing next-generation satellites to handle a higher amount of information flow. Obviously, that indicates an increased confidence in the business.

But we believe we perform well because we're diversified. It's not just disruptive businesses like SpaceX and Tesla. We invest in financial and real asset-type of companies as well. They're the ones that are performing most consistently in this macro-driven market rotation.

Financial businesses are about 14% in the portfolio. All our holdings in this group appreciated this past quarter, mostly driven by the sentiment of increasing interest rates. But while we're benefiting in the short term because of higher rates, that's not the reason we are investors. We are looking for growth companies like **FactSet Research Systems, Inc.** that's actually growing its top line, acquiring new products, and has a great ability to cross-sell to existing customers.

Businesses with real assets, 12% of the portfolio, are also benefiting from macro conditions. Inflation is pushing asset values higher. But we like these companies based on fundamentals. Hyatt, as David mentioned, has a strong financial position and can acquire assets in the faster-growing leisure space.

Core growth is our fourth category. It's probably seen the biggest headwind over the near term due to rotation. We continue to like businesses we're finding here. We're selling positions in companies that are fundamentally challenged such **GDS Holdings, Ltd.,** which is facing increased government regulation in China. But we're retaining companies that aren't fundamentally challenged, where we retain conviction. CoStar, which David also discussed, is a good example. While shares have lagged in recent months, we believe the investments it's making in its residential business is a $1 billion opportunity over the next five years and has a total addressable market of $75 billion in the not-too-distant future.

We believe that broad diversification within these concentrated portfolios explains both Funds' strong performance in 2020 and 2021. We think it should continue to serve us well as we navigate the challenges of the current environment.

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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. Please read them carefully before investing.

All performance and holding information will be based on December 31, 2022, data unless otherwise stated. Performance data quoted represents past performance and past performance is no guarantee of future results. Current performance may be lower or higher than the performance data quoted. All investments are subject to risks and may lose value. The portfolio manager's views are not intended as recommendations or investment advice and are subject to change at any time based on market and other conditions.

Baron Focused Growth Fund's annualized returns for the Institutional Shares as of December 31, 2021: 1-year 19.16%, 5-year 35.44%, 10-year 21.07%. 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 December 31, 2021: 1-year 5.04%, 5-year 17.65%, 10-year 15.75%.

Baron Partners Fund's annualized returns for the Institutional Shares as of December 31, 2021: 1-year 31.73%, 5-year 43.97%, 10-year 28.23%. 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 December 31, 2021: 1-year 12.73%, 5-year 19.83%, 10-year 16.63%.

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 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 40% of the 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 December 31, 2021, for securities mentioned are as follows: Hyatt Hotels Corp.– Baron Focused Growth Fund 5.7%, Baron Partners Fund 3.4%; **Choice Hotels International, Inc.** – Baron Focused Growth Fund 2.9%; **Penn National Gaming, Inc.** – Baron Focused Growth Fund 3.0%, Baron Partners Fund 0.3%; **CoStar Group, Inc.** – Baron Focused Growth Fund 5.5%, Baron Partners Fund 6.3%; **Spotify Technology S.A.** – Baron Focused Growth Fund 4.2%, Baron Partners Fund 2.2%; **Figs, Inc.** – Baron Focused Growth Fund 1.0%; **Tesla, Inc.**– Baron Focused Growth Fund 25.9%, Baron Partners Fund 47.0%; **Space Exploration Technologies Corp.** – Baron Focused Growth Fund 7.8%, Baron Partners Fund 4.8%; **FactSet Research Systems** - Baron Focused Growth Fund 4.8%, Baron Partners Fund 3.7%.

Neither Baron Focus Growth Fund nor Baron Partners Fund owned **GDS Holdings, Ltd**. as of 12/31/2021.

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

Baron Focused Growth Fund Top 10 holdings as of December 31, 2021

Holding	% Assets
Tesla, Inc.	25.9
Space Exploration Technologies Corp.	7.8
Hyatt Hotels Corp.	5.7
CoStar Group, Inc.	5.5
FactSet Research Systems, Inc.	4.8
Arch Capital Group Ltd.	4.8
Guidewire Software, Inc.	4.7
Vail Resorts Inc.	4.7
Spotify Technology S.A.	4.2
Penn National Gaming, Inc.	3.0
Total	71.1

Baron Partners Fund Top 10 holdings as of December 31, 2021

Holding	% Assets
Tesla, Inc	47.0
CoStar Group, Inc	6.3
IDEXX Laboratories, Inc.	5.7
Space Exploration Technologies Corp	4.8
FactSet Research Systems, Inc.	3.7
The Charles Schwab Corp.	3.6
Vail Resorts, Inc.	3.6
Hyatt Hotels Corp.	3.4
Arch Capital Group Ltd.	3.2
Gartner, Inc.	2.5
Total	83.8

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

Definitions (provided by BAMCO, Inc.): The indexes are unmanaged. 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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