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WINNERS' CIRCLE

The Pandemic Year's Top Stock-Fund Managers

In a chaotic period for mutual funds, Morgan Stanley's Dennis Lynch was No. 1, steering his fund to a 273% gain for the 12 months

By Suzanne McGee

In late March of last year, as the world started to deal with the pandemic lockdowns, the U.S. stock market had already hit "reset."

A year later, as investors closed the books for the first quarter of 2021, they are looking back on a market rebound that outdid even the post-financial-crisis recovery for both speed and magnitude.

How did the professional stock pickers at mutual funds do? Overall, no better than an index fund. But the best of them blew away the field—including a spectacular 273% gain for the No. 1 fund, the small-stock-focused Morgan Stanley Inception Portfolio (MSSGX).

The group of actively managed U.S. stock funds that The Wall Street Journal tracks (based on Morningstar data) for its quarterly Winners' Circle survey posted an average gain of 47% for the 12 months ended March 31. While that trailed the S&P 500's 56% total return for the same period—and fell short of recovering all the losses investors incurred during the selloff early in 2020—the best-performing funds did far, far better.

That's a testimonial either to the pros' ability to anticipate the kinds of disruptive change that would benefit the companies they chose to add to their portfolios, or to their ability to tweak their holdings in response to the rapidly changing market environment.

A case in point: Dennis Lynch, head of the Counterpoint Global team at Morgan Stanley Investment Management. Funds managed by Mr. Lynch and his team have routinely earned top honors in the Winners' Circle. This time, it was their small-cap

growth offering, Morgan Stanley Inception.

Mr. Lynch doesn't credit his fund's outperformance to any attempt to pick the bull market's new crop of winners. Rather, his team has long emphasized identifying opportunities in the kinds of disruptive business models that emerged as the winners of the "pandemic market."

Among them: Fastly Inc., whose edge-computing technologies helps improve the performance of cloud-based apps, including the kind of online gaming that many Americans flocked to during lockdowns. Fastly's stock price has soared in the bull market, from lows of \$14 a share in mid-March 2020 to \$70.31 currently. While that's well below its high of \$126 a share last October, the gain was enough—in combination with big moves by other Inception holdings—to boost the fund to the top of the heap.

"We prioritize long-term thinking over knee-jerk reactions, especially during a period of turmoil and crisis like last year," Mr. Lynch says.

As always, the Journal isn't recommending that investors view the quarterly ranking as a shopping list. Many of the funds may have high fees, or be closed to new investors or otherwise inaccessible. But their managers may still offer our readers insight into what's happening in the market. The survey also includes only actively managed mutual-fund portfolios with a three-year record and more than \$50 million in assets; it excludes sector funds, quantitative funds and funds that employ leverage.

Small stocks strutted

Funds concentrating on small-



No. 1 manager Dennis Lynch of Morgan Stanley Inception (center), runner-up Darren Chervitz of Jacob Discovery (top left) and No. 3 finisher Michael Baron of Baron Partners (top right). SEAN MCCABE

cap or microcap stocks dominated the list of winners. That doesn't surprise Scott Opsal, director of research for Leuthold Group of Minneapolis. "Huge returns coming off a bear market's bottom are pretty typical," he says. "In a bear market, investors turn conservative; in the first leg of a bull market recovery, they're willing to invest in less-stable businesses, to take a flier on less-established businesses and look to the future for their rewards."

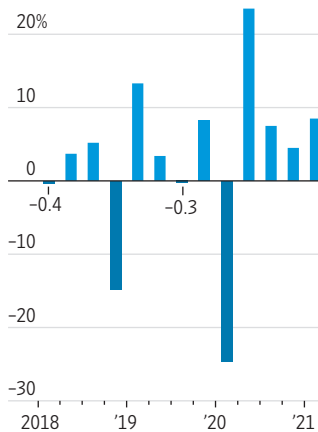
What is unusual about the past 12 months, Mr. Opsal notes, is

the speed and magnitude of the recovery. "We got so much stimulus right away, so the bottom was sharp and quick," he says.

"I would never in a million years have envisioned this kind of market recovery," says Darren Chervitz, portfolio manager of Jacob Discovery Fund (JMIGX), the No. 2 Winners' Circle finisher. "We've had more than 26 portfolio names post gains of more than 100% in the last 12 months." That propelled Mr. Chervitz's fund 220% higher for the 12-month period.

Score at the Quarter

Stock funds rose for the fourth straight quarter, following the first-quarter 2020 debacle. Average total return for U.S. diversified funds.



Source: Refinitiv Lipper

Mr. Chervitz's willingness to adjust holdings as the bull market has evolved helped ensure he handily beat top-ranked Morgan Stanley Inception in a more-volatile first quarter. Mr. Chervitz's fund has delivered a year-to-date gain of 37%, compared with 23% for Morgan Stanley Inception.

Jacob Discovery Fund's assets under management ballooned in response to these returns, thanks both to capital gains and to an inflow of new cash, from only \$10 million at the market's nadir in March 2020 to about \$100 million a year later. Partly as a response to this and in part due to changing nature of the market, Mr. Chervitz oversaw a gradual expansion in the number of holdings from 40 to 60 companies.

"When the pandemic first hit, I sought out companies that I thought would benefit from medical innovations as well as from people staying home: that was the first wave for me," says Mr. Chervitz.

He also added to positions in companies like Arcturus Therapeutics Holdings Inc., which is developing mRNA-based vaccines (including another Covid-19 vaccine candidate) but also using the same genetic research

to devise therapies able to treat diseases like cystic fibrosis. The stock's price has tripled over the past 12 months, but it's the longer-term outlook that Mr. Chervitz finds intriguing.

"I see the potential for this kind of new medical technology to significantly expand lifespan over the coming decades," he argues.

Scientific change

Looking past the immediate beneficiaries of the stay-at-home phenomenon, Mr. Chervitz sought out other business models that could benefit from a willingness to embrace scientific and business change. Alphatec Holdings Inc., under the leadership of a new chief executive, Patrick Miles, fell into that camp, he says, as it has rolled out a series of innovations targeting spinal surgery, such as software that tells surgeons about the health of nerves during operations.

More recently, he has invested in a cryptocurrency broker, Voyager Digital Ltd. (listed on Canada's over-the-counter market), whose biggest problems may lie in managing runaway revenue growth, he argues. "Although it has gone from being a penny stock to trading at more than \$30 Canadian dollars a share, its valuation is still lower than the one being discussed for Coinbase's likely initial offering," he adds.

Jeff James, the lead portfolio manager of Driehaus Micro Cap Growth (DMCRX), which ended our competition in fifth place with a 12-month return of 175% and advanced nearly 13% in the first quarter, also has been actively readjusting his portfolio in response to the shifts in the economy and the market, adding that active stock-picking has helped his performance. (The fund is closed to new investors, though the Driehaus small-cap fund, which Mr. James says has about a 50% overlap in holdings with the microcap fund, remains open.)

"For the first half of the last 12 months, the market has really been about pandemic beneficiaries," Mr. James says, including some of the fund's existing holdings. These included Freshpet Inc., which provides pandemic puppies and kittens (as well as other

animal companions) with refrigerated fresh foods, and Fulgent Genetics, which developed some of the widely used Covid-19 tests and which now is pushing forward with research and development of many kinds of genetic tests.

"As it became clear we'd have effective vaccines emerge, I've started shifting my emphasis and looking for companies that will benefit most from a reopening," Mr. James says. For instance, he took a stake in Bally's Corp., which owns casinos in a number of regional markets (including Colorado and Rhode Island), as well as racetracks and an array of online gaming products. "We bought this in the second half of last year, expecting that while online gaming would continue in the reopening, Bally's would benefit from a surge in activity at its casinos," adds Mr. James.

The Driehaus fund has benefited from this decision to try to track the evolution of the pandemic and its impact on an array of businesses. Early on, Mr. James says, the consumer discretionary sector was the worst performer for his fund, but a growing interest in home furnishings and outdoor-related activities had transformed it into the single largest contributor to returns by the first quarter of 2021. Holdings in stocks like Nautilus Inc. (a maker of fitness equipment, whose shares have exploded in value from about \$2.50 a year ago to more than \$16 by March 31) and Lovesac (a specialist modular furniture maker, whose stock has soared from less than \$5 to nearly \$60 over the past 12 months) were among the leaders.

Baron's test of time

Not all top-performing fund managers relied on the ability to identify the biggest beneficiaries of the new bull market as it unfolded to generate gains. Baron Partners Fund (BPTRX) earned third place in this quarter's rankings with a 12-month return of 212%, thanks to its managers' early decision to invest in stable but high-growth businesses.

"All of our core holdings had been in the fund prior to February 2020," says Michael Baron, who manages the fund alongside his

father, veteran investor Ron Baron. "We don't try to outsmart the market, but we look for high-quality businesses able to weather the storms and continue to grow, in businesses that we feel will be much larger in five years' time."

Mr. Baron attributes the outsize gains in many growth companies, and especially among the ranks of smaller stocks, to the fact that the pandemic seems to have accelerated the pace of economic change. "A lot of growth projections we had established for our holdings for the next several years were pulled forward, and realized in a much shorter timespan," he says.

The pandemic-related trends contributed to this new focus and sense of momentum, Mr. Baron argues. Legacy businesses weren't able to modify their business plans rapidly, so disruptive companies offering new models were able to capitalize on that.

For instance, Zillow Group Inc. already has captured more attention from eager home buyers (encouraged by ultralow interest rates) reluctant to tour homes in person in the company of a real-estate agent. Tesla Inc., the fund's largest holding, came to be seen not only as the maker of more environmentally friendly cars, but as a consumer-friendly business in a pandemic.

"Fewer people touch the vehicles when they're made, and there's no need to go to a dealership and interact with other people to make the purchase or get the vehicle serviced," says Mr. Baron.

The No. 4 finisher was Hodges Fund (HDPMX), with a 182% gain under Craig Hodges. It employs a "go anywhere" approach that enabled Mr. Hodges to add (and later subtract) pandemic-economy winners like Zoom Video Communications Inc. More recently, the fund has diversified, adding small positions in sports betting firms (DraftKings Inc.) and food-delivery companies (Waitr Holdings Inc.) Like Mr. James at Driehaus, Mr. Hodges benefited from a stake in Nautilus and ventured further into the outdoor-sports arena with a stake in Callaway Golf Co.

Ms. McGee is a writer in New England.

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Baron Partners Fund's annualized returns for the Retail Shares as of March 31, 2021: 1-year, 212.21%; 5-years, 37.67%; 10-years, 22.81%; Since Inception (1/31/1992), 16.23%. Annual expense ratio for the Retail Shares as of December 31, 2020 was 1.56% (comprised of operating expenses of 1.31% and interest expense of 0.25%).

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, 2031, 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.

Top 10 Holdings as of 3/31/2021:

Holding	% Holding
Tesla, Inc.	40.2
CoStar Group, Inc.	8.7
IDEXX Laboratories, Inc.	5.6
Zillow Group, Inc.	5.2
Space Exploration Technologies Corp.	4.9
Vail Resorts, Inc.	4.2
The Charles Schwab Corp.	3.7
Arch Capital Group Ltd.	3.6
Hyatt Hotels Corp.	3.5
FactSet Research Systems, Inc.	3.1
Total	82.7
Long Equity Exposure	103.3
Cash & Equivalents	(3.3)

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

Risks: The Fund is non-diversified which means, in addition to increased volatility of the Fund's returns, 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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