

DEAR BARON FIFTH AVENUE GROWTH FUND SHAREHOLDER:

PERFORMANCE

Baron Fifth Avenue Growth Fund® (the Fund) lost 3.5% (Institutional Shares) during the third quarter, which compares to losses of 3.1% for the Russell 1000 Growth Index (R1KG) and 3.3% for the S&P 500 Index (SPX), the Fund's primary and secondary benchmarks, respectively. Year-to-date, the Fund is up 34.0% compared to gains of 25.0% for the R1KG and 13.1% for the SPX Indexes.

Table I.
Performance†
Annualized for periods ended September 30, 2023

	Baron Fifth Avenue Growth Fund Retail Shares ^{1,2}	Baron Fifth Avenue Growth Fund Institutional Shares ^{1,2,3}	Russell 1000 Growth Index ¹	S&P 500 Index ¹
Three Months ⁴	(3.54)%	(3.48)%	(3.13)%	(3.27)%
Nine Months ⁴	33.73%	33.99%	24.98%	13.07%
One Year	24.19%	24.53%	27.72%	21.62%
Three Years	(7.49)%	(7.25)%	7.97%	10.15%
Five Years	4.15%	4.41%	12.42%	9.92%
Ten Years	10.18%	10.46%	14.48%	11.91%
Fifteen Years	9.84%	10.11%	13.67%	11.28%
Since Inception (April 30, 2004)	8.20%	8.40%	10.91%	9.37%

To a casual observer, a modest pullback in the third quarter might seem par for the course. After two consecutive quarters of strong double-digit gains, a small step back and a period of consolidation would seem to be appropriate. That, of course, does not tell the entire story.

The quarter began with a steady dose of good news. Inflation continued to slow down to around 3.7%, while growth and economic activity remained surprisingly strong. Federal Reserve (the Fed) Chairman Jerome Powell pointed out in a speech that the U.S. economy has been more resilient than almost anyone expected. The probability of a soft landing was steadily



ALEX UMANSKY

PORTFOLIO MANAGER

Retail Shares: BFTHX
Institutional Shares: BFTIX
Shares: BFTUX

increasing. The Fund gained an additional 6.7% in the month of July, on top of the 38.8% gain in the first six months of the year. But just as night follows day, the talk of good news makes investors think of the bad news that could follow. The obvious bad news scenario is higher interest rates or as the talking heads refer to it *higher for longer*. And so, while the Fed kept rates on hold for now, it delivered a stern message and managed to jolt the markets into believing that borrowing costs are going to stay higher for a while, the implication being fewer rate cuts next year with a potential negative impact on the broader economy. Add to this \$90 oil, the expanding auto workers strike, the prospect of a government shutdown, and increasing geopolitical uncertainty; and the context for a market pullback was set. The Fund lost 4.5% in August and another 5.2% in September, ending the quarter with a 3.5% loss, roughly in line with its benchmarks.

Performance listed in the table above is net of annual operating expenses. The gross annual expense ratio for the Retail and Institutional Shares as of September 30, 2022 was 1.03% and 0.76%, respectively, but the net annual expense ratio was 1.00% and 0.75% (net of the Adviser's fee waivers), respectively. 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 Fund expenses pursuant to a contract expiring on August 29, 2034, 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 baronfunds.com or call 1-800-99-BARON.

† The Fund's 5- and 10-year historical performance was impacted by gains from IPOs and there is no guarantee that these results can be repeated or that the Fund's level of participation in IPOs will be the same in the future.

¹ The **Russell 1000® Growth Index** measures the performance of large-sized U.S. companies that are classified as growth. The **S&P 500 Index** measures the performance of 500 widely held large-cap U.S. companies. All rights in the FTSE Russell Index (the "Index") vest in the relevant LSE Group company which owns the Index. Russell® is a trademark of the relevant LSE Group company and is used by any other LSE Group company under license. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. The Fund includes reinvestment of dividends, net of withholding taxes, while the Russell 1000® Growth Index and S&P 500 Index include reinvestment of dividends before taxes. Reinvestment of dividends positively impacts the performance results. The indexes are unmanaged. Index performance is not Fund performance. Investors cannot invest directly in an index.

² The performance data in the table does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or redemption of Fund shares.

³ Performance for the Institutional Shares prior to May 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 May 29, 2009 did not reflect this fee, the returns would be higher.

⁴ Not annualized.



Baron Fifth Avenue Growth Fund

In our last quarterly letter, we explained how we believe stock prices have two components to them: business fundamentals, which can be measured by revenues, earnings, and ultimately cash flows, and then a multiple that investors are willing to pay for those fundamentals. During the third quarter, our analysis suggests that at the portfolio level, the fundamentals of our businesses improved with revenue and profit expectations rising, while the multiples of how much investors were willing to pay for these profits took another leg down, declining 12.3%, and making our companies even more attractive in our view.

From a performance attribution perspective, our investments in Information Technology (IT) and Consumer Discretionary outperformed, while holdings in Financials, Communication Services, and Health Care detracted. At the company level, we had 13 contributors against 17 detractors. **Rivian**, **argenx**, **NVIDIA**, **CrowdStrike**, and **Endava** were our largest winners adding 218bps to absolute returns, while smaller investments, **Atlassian** and **EPAM** both posted double-digit percentage gains during the quarter. On the other side of the ledger **Adyen**, **Shopify**, **Intuitive Surgical**, **Snowflake**, and **Block** were our largest detractors, costing the Fund 393bps combined. **ZoomInfo**, **ASML**, **illumina**, and **GitLab** were the other double-digit decliners.

Looking under the hood, company fundamentals are stable and appear to be improving.

At the portfolio level, the positive fundamental trends we observed in the second quarter continued into the third quarter. Weighted average revenue growth expectations for 2023 increased by 4.0%, or by 1.4% if we exclude NVIDIA. We wrote at length about NVIDIA earlier this year, but it is worth mentioning that the company has continued to exceed its own projections and the Street's most optimistic expectations. After raising its revenue and EPS guidance for 2023 by 40% and 69%, respectively following its last quarter, NVIDIA increased it further by 26% and 35%, respectively after reporting the most recent one. Consensus expectations now call for revenues to grow 94% this year, while earnings per share are expected to increase 192%. You may have seen these kinds of growth rates before, but we doubt you saw them from a company generating \$50 billion in revenues. The skeptics who continue to question and doubt the accelerating demand for Generative AI forgot to tell NVIDIA about it. But we digress...Back to the portfolio...profit expectations have risen even faster than revenues and were up 10.6% during the third quarter (or up 7.1% ex-NVIDIA) with margin expectations up 167bps (124bps ex-NVIDIA). So, broadly speaking, our companies are seeing continued improvement in overall business trends, which flow through to their bottom lines, driving higher margins. We are also starting to see the benefits of leaner cost structures and more disciplined capital allocation compared to two or three years ago when capital was both cheaper and more readily available.

Could our companies' fundamentals start to deteriorate again? Sure, if macro headwinds intensify. Would it significantly impair their long-term value? Unlikely, in our view. The majority of the businesses we own have no financial leverage and are capital light – meaning that higher interest rates would not directly have a negative impact on their businesses. They are leaders in their industries and should continue to benefit from customers consolidating in favor of their most important vendors. They are run by what we believe are great management teams and offer critical solutions to their customers, which makes them stickier and gives them pricing power.

But multiples took another leg down...

While fundamentals appear to have turned the corner, the Fund's holdings experienced a multiple contraction of 12.3% during the third quarter¹ as we continue to operate in a challenging environment. The culprit behind the multiple contraction in the quarter was a combination of rising rate expectations or the *higher-for-longer* narrative, along with deteriorating investor sentiment, which led to a sell-off in longer-duration assets. The bears argue that higher for longer will undoubtedly lead to a recession as consumers have depleted the extra savings from the COVID period, and they are now facing a resumption of student loan payments and rising credit card bills. In the meantime, the affordability of large purchases like houses or cars has deteriorated (mortgage rates are approaching 8%, while car loan rates are even higher). The bulls continue to argue that the tightening cycle is mostly over, and that the economy has proven to be resilient as is evidenced by strong GDP and employment growth numbers. Inflation has been mostly tamed, and the next major Fed move in interest rates (sooner or later) is surely down. The 10-year inflation break-even rate, which we like to look at, has been hovering around 2.0% to 2.5%. A recession is far from a foregone conclusion, and we believe the Fed has likely threaded the needle and engineered a soft landing. While we do not belong to either camp, we would point out that if the bears are right and the economy slips into a recession, the Fed will likely lower rates sooner and will do it more aggressively, whereas if the bulls prove to be correct, inflation will likely remain stickier leading to even *higher-for-longer* rates than investors are currently pricing in. This logic is of course circular with each argument leading into and supporting the other, enabling both sides to continue to stand their ground.

Mega caps and the Magnificent Seven are still dominating R1KG's returns year-to-date.

As of the end of the third quarter, large caps, which are defined as companies with market cap of \$143.6 billion or above and represented 68.4% of the R1KG, were responsible for **82%** of the index's year-to-date gain of 25%. While we owned the right large cap stocks – our investments were up 80% year-to-date compared to 35.5% for the R1KG's large caps – our overall performance would have been better had we owned more of them. We were **28.8%** underweight large caps. Philosophically, this should not come as a surprise. We are focused on Big Ideas and companies that tend to be earlier in their penetration curves and growth lifecycles, so we gravitate towards the lower end of large caps. Interestingly, our absolute exposure to this category is more or less in line with our historical average, while the weight of large caps in the R1KG is nearly 20% higher than its historical average since 2010.

Within the large – cap group lies the Magnificent Seven, which we like to classify as mega caps. The magnificent seven continue to lead the benchmark's returns – Amazon, Alphabet, Meta, Apple, Tesla, NVIDIA, and Microsoft were up an impressive 87.9% on average, year-to-date, and responsible for **74%** of R1KG's 25% return and **90%** of large cap's contribution year-to-date. While we own only four of them – Amazon, Meta, Tesla, and NVIDIA, we own the right four, as they were up significantly more than the rest with *NVIDIA up 198%*, *Meta up 149%*, *Tesla up 103%*, and *Amazon up 51%* year-to-date. Interestingly, other than Tesla, most of the returns have been driven by improving profits rather than

¹ We calculate the weighted average change for the portfolio and either use a P/E multiple or an EV/Revenue multiple based on FactSet consensus expectations for the next 12 months for each stock (and choose which multiple to use depending on whether the company has significant near-term profits on which a meaningful P/E can be calculated).

multiple expansion. NVIDIA's P/E multiple (on forward 12-month consensus EPS estimates) is down 13.5% year-to-date, Amazon's P/E multiple is down 6.6%, and Meta's P/E multiple is up 27.4% although its historically low starting point of 14.7 suggests more of a reversion to the mean than structural multiple expansion. As a percentage of total stock return, Meta's multiple expansion accounts for just 18% of the stock's return year-to-date.

Why have the mega caps outperformed?

During times of increased uncertainty and stress, investors' time horizons shrink significantly. With their focus shifting to the here and now, current profitability and cash-flow generation take center stage. All of these companies have a few things in common: they are highly profitable, they have no or low debt, so they're not highly levered, they have high returns on invested capital, and historically, they have always used recessions and economic turmoil to their advantage. As the competitors and the upstarts struggle and are forced to pull back because they're fighting for survival, the leaders take market share, consolidate their power, and often emerge even stronger than they were before. It is also worth mentioning that growth in passive investment vehicles has led to increased allocations to the largest market cap stocks (they are the biggest weights in indexes) as passive index funds and ETFs must continually buy without regard to fundamentals or valuations.

Is there anything we can do to reduce or mitigate the risk of further multiple contraction?

Sure. We could sell higher-multiple, higher-quality businesses, and buy lower-multiple, lower-quality ones. We could rotate out of Technology, Health Care, Consumer Discretionary, and Financials into Energy, Staples, Utilities, or Gold. We could sell and go to cash. The main reason we do not employ these tactics is that we do not *rent* stocks – we own businesses. A long-term ownership mindset is foundational to our investment philosophy and process, and we are willing to live with the volatility of valuation multiples and stock prices over full-market cycles.

We don't rotate sectors, go to cash, or buy mediocre businesses because it is outside of our circle of competence, and because we believe that investing in high-quality businesses over the long term will enable us to outperform the indexes even though we may have to endure higher market volatility. The less attractive longer-duration stocks become to other market participants due to short-term issues and concerns, the more attractive they become to us as long-term investors – all else being equal, we would rather buy a business when its selling at a larger discount to intrinsic value because everyone is focused on the here and now at the expense of thinking and analyzing the long-term prospects of the business.

It is important not to lose sight that mathematically, an investor's return will be determined by the change in multiple over the holding period, multiplied by the compounding growth in business' fundamentals over the holding period. The longer the holding period, the less important changes in multiples become (since these multiple changes are linear, while fundamentals compound exponentially). Multiple contraction that our stocks suffered over the last 21 months while fundamentals continued to compound, make current stock prices attractive for long-term investors, in our view.

So, what are we doing?

We continue to do what we always do. Focus on trying to understand disruptive change. Meet with companies, do fundamental research, and analyze businesses that can become Big Ideas over time. In early September,

we travelled to Japan and Korea and met with half a dozen companies. The newest investment in the Fund comes as a result of this trip.

Coupang is a leading Korean e-commerce company founded in 2010. It went public in March of 2021, and we have been investors in the company in our Global Advantage Fund since the IPO. After spending half a day with management, touring the company's fulfillment center, asking questions, and learning more about the reasons behind the remarkable success the company has achieved in the last 13 years, we decided we wanted to own it in this Fund as well. When we originally invested in Coupang, our thesis was constructed around the company's wide product selection, low prices, and unrivaled convenience thanks to its investments in an end-to-end infrastructure that covers over 70% of Korea's population, enabling over 99% of orders to be delivered within one day or less, rather than the industry norm of two to three days, driving customer satisfaction, which translates to higher customer retention rates and lifetime value. We thought that Coupang would continue to gain market share in the U.S. \$500 billion-plus Korean retail market, while expanding its offerings into additional categories, expanding its ecosystem via a third-party marketplace, and continuing to invest in infrastructure density to further capture inefficiencies, enhancing the customer experience, and improving profit margins. The company has since outperformed our expectations, growing its market share to 25% (#1 in the industry), despite not being a first mover, while building an unrivaled user experience with 99.8% of products delivered the next day (with the majority of them by dawn) and becoming profitable significantly faster than we expected. Our biggest takeaway from the visit was that despite all of Coupang's success, there is still a long runway of growth ahead. For example, while most of the facility we visited is operated with pickers going to shelves to pick up items for orders, there was one room in which *shelves drove themselves to pickers* on the back of autonomous robots, which *increased picker productivity by 3x*. Additionally, while Coupang has been striving to reduce its reliance on distributors, which enables them to expand margins while lowering prices for consumers, a significant opportunity remains for further reduction. Lastly, we got plenty of examples of out-of-the-box thinking (no pun intended) – from the company's singulation process (improves the picking process by reducing the constraint to search for items order by order), decreasing use of boxes (80% of shipments are now *boxless*), enabling grocery delivery without cold-chain logistics (thanks to end-to-end supply-chain efficiency), or how Coupang is able to fill trucks so that each carries more than 2x the parcels a UPS or a FedEx truck can, despite being half the size. The 4% free-cash-flow yield, which is also negatively impacted by the significant reinvestments the company is making into its emerging offerings, also contributed to our decision to add Coupang to the portfolio upon returning to New York.

Table II.
Top contributors to performance for the quarter ended September 30, 2023

	Quarter End Market Cap (billions)	Percent Impact
Rivian Automotive, Inc.	\$23.0	0.72%
argenx SE	28.8	0.46
NVIDIA Corporation	1,074.4	0.41
CrowdStrike Holdings, Inc.	40.0	0.35
Endava plc	3.3	0.25

Shares of **Rivian Automotive, Inc.**, a U.S.-based electric vehicle manufacturer, continued their volatile trading, and after declining during the

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first half of 2023, rose 45.9% during the third quarter. Rivian's unit economics are improving as a result of several factors: i) the company's production rate is increasing, which enables it to better absorb fixed costs; ii) Rivian is ramping up the usage of more price effective technologies, such as LFP batteries and its in-house developed motor, Enduro; and iii) the company is benefiting from renegotiated supplier agreements, as its scale and purchasing power have significantly increased over the last few years. Management expects continued progress in profitability ahead as Rivian further scales production. We remain shareholders and believe that the release of Rivian's new smaller SUV dubbed R2, which is planned for early 2024, would enable the company to compete in the higher volume SUV segment, and significantly expand its addressable market. On the liquidity front, we expect the company to raise additional funds to support its longer-term business plans.

Argenx SE is a biotechnology company focused on autoimmune disorders. Shares increased 26.3% in the third quarter following positive chronic immune demyelinating polyneuropathy (CIDP) Phase 3 trial results. CIDP is an important commercial market representing billions of dollars in potential sales, and investors viewed this data set as a high-profile catalyst. Overall, we believe that the strong Vyvgart launch, with early sales tripling consensus expectations and global approvals coming earlier than guided, will drive revenue growth over the next few years. Furthermore, we expect the next few years to have many catalysts, including readouts in pemphigus vulgaris, immune thrombocytopenic purpura, bullous pemphigoid, myositis, and argenx's subcutaneous formulation launch. We believe that positive readouts would expand argenx's opportunity set and therefore remain shareholders.

NVIDIA Corporation is a fabless semiconductor company that designs chips and software for gaming and accelerated computing. Shares rose 2.8% during the third quarter and have nearly tripled year-to-date, as the company continues reporting unprecedented growth as a result of the acceleration in demand for its datacenter GPUs. After reporting revenue of \$7 billion in the first quarter and providing guidance of \$11 billion for the second quarter, NVIDIA reported revenue of \$13.5 billion and guided for another step up into the third quarter to \$16 billion of revenue. This extraordinary growth is being driven by the accelerating adoption of generative AI (GenAI). We are at the tipping point of a new era of computing with NVIDIA at its epicenter. While the opportunity within the data center installed base is already large at roughly \$1 trillion, the pace of innovation in AI in general, and GenAI in particular, should drive a significant expansion in the addressable market, as GenAI creates a new way for human-computer interaction through language, and as companies are better able to utilize their data for decision-making. We remain shareholders.

Table III.

Top detractors from performance for the quarter ended September 30, 2023

	Quarter End Market Cap (billions)	Percent Impact
Adyen N.V.	\$22.9	-1.29%
Shopify Inc.	70.1	-0.72
Intuitive Surgical, Inc.	102.7	-0.69
Snowflake Inc.	50.4	-0.62
Block, Inc.	27.0	-0.61

Adyen N.V. provides technology that enables merchants to accept electronic payments. Shares declined 58.1% during the third quarter after the company reported disappointing financial results for the first half of the

year. While payment volume growth of 23% was solid, it had slowed significantly from 41% in the prior period, which management attributed to more intense competition and pricing pressure in North America. Adyen is still gaining market share, but we believe the company lost wallet share with a few large merchants who shifted volumes to lower-priced competitors. We trimmed the position but continue to own the stock because we believe Adyen will be a prime beneficiary of the secular growth of e-commerce and will continue gaining share over time.

Shopify Inc. is a cloud-based software provider for multi-channel commerce. Shares gave back some of their strong performance from the first half of 2023, declining 15.4% on the back of rising concerns related to the health of the consumer and the expansion of TikTok and Temu (owned by the Chinese e-commerce player, Pinduoduo) into the U.S. While we are cognizant of these near-term risks, we believe that Shopify will continue to benefit from its position as the commerce operating system for its merchants. Rather than replacing Shopify, various selling channels, including TikTok, are managed within the platform, which should enable Shopify to maintain its competitive advantage over the long term. During the quarter, Shopify announced an agreement with Amazon that will allow merchants to offer *Buy with Prime* within the Shopify ecosystem, enabling Shopify to act as the payments provider for these transactions and alleviating a key concern. Lastly, the company also reported strong financial results, including 17% year-over-year gross merchandise volume growth, 31% revenue growth, and consensus-beating non-GAAP operating income that outpaced estimates by over \$90 million. We remain shareholders due to Shopify's strong competitive positioning, innovative culture, and long runway for growth, as it still holds less than a 2% share of the global commerce market.

Intuitive Surgical, Inc. manufactures and markets the da Vinci Surgical System, a robotic system used for minimally invasive procedures. The stock declined 14.5% during the third quarter due to investor concerns about a slowdown in systems sales and procedures in China, where the government has embarked upon an anti-corruption campaign that may cause disruption in the region. Investors have also reacted to management's commentary about a potential slowdown in bariatric procedures due to the increased adoption of obesity medications such as Wegovy. We think disruption in China is temporary; meanwhile bariatric procedures represent a small fraction of the overall range of procedures Intuitive targets. We believe the long-term outlook for the company is positive. Procedure growth on Intuitive systems is rising at a solid rate, and we think the business will continue advancing its technological lead as it invests heavily in research and development.

PORTFOLIO STRUCTURE

The Fund is constructed on a bottom-up basis with the quality of ideas and level of conviction playing the most significant role in determining the size of each investment. Sector weights tend to be an outcome of the portfolio construction process and are not meant to indicate a positive or a negative view.

As of September 30, 2023, the top 10 holdings represented 59.1% of the Fund, the top 20 represented 87.1%, and we exited the quarter with 30 investments.

IT, Consumer Discretionary, Health Care, Communication Services, and Financials made up 97.8% of net assets. The remaining 2.2% was made up of **GM Cruise** and **SpaceX**, our two private investments classified as Industrials, and cash.

Table IV.
Top 10 holdings as of September 30, 2023

	Quarter End Market Cap (billions)	Quarter End Investment Value (millions)	Percent of Net Assets
NVIDIA Corporation	\$1,074.4	\$48.9	10.6%
Amazon.com, Inc.	1,311.6	36.6	7.9
ServiceNow, Inc.	114.0	30.4	6.6
Meta Platforms, Inc.	772.5	27.3	5.9
Tesla, Inc.	794.2	24.3	5.3
Mastercard Incorporated	373.0	22.6	4.9
Shopify Inc.	70.1	21.9	4.8
Intuitive Surgical, Inc.	102.7	21.9	4.7
Snowflake Inc.	50.4	21.0	4.6
The Trade Desk	38.3	17.8	3.9

RECENT ACTIVITY

During the third quarter, we bought 1 new name – the Korean e-commerce leader, **Coupang**. We also slightly reduced 5 existing holdings in order to reallocate to stocks in which we saw a more attractive long-term risk/reward profile. Overall, we added to 10 existing positions, including the leading commerce platform **Shopify**, the autoimmune-focused biotechnology company **argenx**, the leading e-commerce platform **MercadoLibre**, the outsourced software and digital IT services company **Endava**, the leading cloud security and network infrastructure provider **Cloudflare**, and the connected TV leader **Trade Desk**, among others.

Table V.
Top net purchases for the quarter ended September 30, 2023

	Quarter End Market Cap (billions)	Net Amount Purchased (millions)
Coupang, Inc.	\$30.3	\$5.3
Shopify Inc.	70.1	3.1
argenx SE	28.8	2.6
MercadoLibre, Inc.	63.5	2.1
Endava plc	3.3	2.0

As described above, we added **Coupang, Inc.** to the portfolio this quarter. Coupang is a leading e-commerce platform in Korea with significant runway to win market share, grow into to new categories (such as grocery), and expand its profitability as the business scales and as merchants adopt its advertising and fulfillment offerings.

We also added to our existing **Shopify Inc.** position. Shopify is a leading commerce platform, enabling independent merchants (of increasingly larger scale) to start and operate a multi-channel commerce business on its platform. In our view, Shopify continues to progress in its efforts to expand its addressable opportunity both horizontally (making its offering the best choice for a larger percentage of potential merchants from the smallest start-ups to large established companies) and well as vertically, through investments in research and development to deepen its platform natively and through ecosystem partners. During the quarter, Shopify also alleviated an important risk factor by reaching a deal with Amazon to natively support Amazon’s new Buy with Prime offering. This offering enables merchants who also use Amazon’s multi-channel fulfillment services to offer prime shipping on their own Shopify websites. According to the deal, Shopify would be the

payment provider for Buy with Prime transactions, and therefore should not be negatively impacted even if Buy with Prime becomes highly successful (it could even benefit from the improvement in conversion rate if consumers end up buying more through Buy with Prime). Shopify also continues to accelerate the velocity of its product innovation, announcing over 100 new products in its recent summer Shopify Editions product release. For example, Shopify announced a suite of AI solutions called Shopify Magic and AI Sidekick, which would provide a personalized, contextually relevant assistant for merchants helping with store building, marketing, customer support, and back-office management. Shopify’s vision is to leverage its large aggregate scale (and data) for the benefit of all its merchants (including the smallest). While a potential deterioration in the macro environment could result in near-term headwinds, we believe that the stock offers an attractive long-term risk/reward profile and therefore decided to add to our position.

We also added to our biotechnology investment, **argenx SE**, during the quarter, as the positive readout from the CIDP trial increased our conviction in the platform opportunity for Efgartigimod across a large number of additional indications.

Another name we added to during the quarter was the Latin-American e-commerce platform, **MercadoLibre, Inc.** The company continues to execute at the highest level, reporting second quarter revenue growth of 57% year-over-year in local currency with operating margins reaching 16.3%. The company continues to gain market share, taking advantage of its differentiated competitive positioning, enabling convenience, rapid delivery speeds, and vast selection of SKUs to its customers. We continue to be excited about the company’s long runway for growth as e-commerce remains underpenetrated in the region and as the company innovates and further deepens its platform and ecosystem over time.

We also continued to add to our position in **Endava plc** as the stock remained volatile on macro headwinds, which led to uncertainty in customer budgets and a temporary slowdown in the business, with the company expecting revenue growth to decline from over 21% year-over-year in fiscal year 2023 (ending in June 2023) to 1% to 3% for fiscal year 2024. This, together with ongoing investor concerns around the potential negative impact of GenAI on the company’s business, creates a positively skewed risk/reward equation for long-term investors, in our view. Despite the wider range of outcomes in the near term, we believe that the demand for digitization will only strengthen as AI adoption grows, while the eventual macro recovery would enable the company to reaccelerate revenue growth and recover its operating margins.

Table VI.
Top net sales for the quarter ended September 30, 2023

	Quarter End Market Cap (billions)	Net Amount Sold (millions)
CrowdStrike Holdings, Inc.	\$40.0	\$3.7
Veeva Systems Inc.	32.7	1.0
Datadog, Inc.	29.6	0.7
Adyen N.V.	22.9	0.7
EPAM Systems, Inc.	14.8	0.6

During the third quarter, we reduced our investment in five existing positions and reallocated to names in which we saw a more positively skewed risk/reward equation.

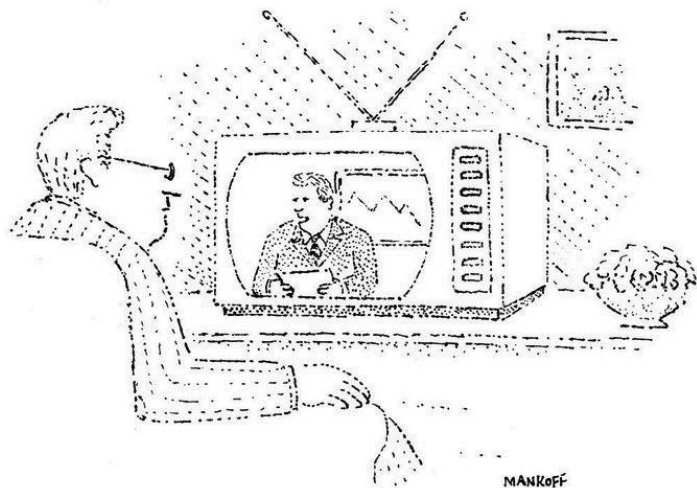
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OUTLOOK

It seems that the topic du jour of financial commentators moved from "how high can rates go?" to "how long would rates need to stay at these higher levels?", or the *higher-for-longer* discussion. The bond market has clearly moved in that direction with the 10-Year U.S. Treasury bond yield increasing nearly 100bps from 3.81% as of the end of the second quarter to 4.80% at the end of the third. This caused the Vanguard Long-Term Bond ETF to crater 14% from the beginning of the quarter through the middle of October. In the meantime, the 10-year break-even inflation rates remain in the 2.0% to 2.5% range, where they have been for the last three years, and real rates (as measured by 10-Year TIPS) have risen all the way up to 2.3%. We get why long-duration assets sell off on a *higher for longer* scenario, but we are uncertain how sustainable/persistent it will turn out to be. We think the consensus view on *higher* has already moved to *not much higher*, and we think the answer to how much *longer* is *not much longer*. In other words, it will be measured in months or quarters and not years, which for our purposes – is not much longer at all.

It also never ceases to amuse us how the market can react to similar data one way on a good day, and in an entirely different way on a bad one. After the August job openings (JOLTS) report was published on Tuesday, October 3, showing that the economy had 9.6 million job openings, which was more than expected, the market sold off, with the SPX losing 1.4%, and the R1KG down 1.8%. This move was consistent with the *higher-for-longer* narrative, and the 10-Year Treasury yield did in fact spike 12bps that day in response to the news. Then on Friday, October 6, we got the nonfarm payroll report, showing again a much higher-than-expected number of 336,000 as compared to consensus expectations of 170,000. A consistent data point to what we saw just three days earlier, in our opinion. But the SPX went straight up that day closing with a 1.2% gain, while the R1KG rose 1.7%, with what looked to us like similar and consistent data causing the exact opposite effect on market movement and our stock prices.

This reminded us of the famous Mankoff cartoon from 1981:



"On Wall Street today, news of lower interest rates sent the stock market up, but then the expectation that these rates would be inflationary sent the market down, until the realization that lower rates might stimulate the sluggish economy pushed the market up, before it ultimately went down on fears that an overheated economy would lead to a reimposition of higher interest rates."

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Every day we live and invest in an uncertain world. Well-known conditions and widely anticipated events, such as Fed rate changes, ongoing trade disputes, government shutdowns, and the unpredictable behavior of important politicians the world over, are shrugged off by the financial markets one day and seem to drive them up or down the next. We often find it difficult to know why market participants do what they do over the short term. The constant challenges we face are real and serious, with clearly uncertain outcomes. History would suggest that most will prove passing or manageable. The business of capital allocation (or investing) is the business of taking risk, managing the uncertainty, and taking advantage of the long-term opportunities that those risks and uncertainties create.

We are optimistic about the long-term prospects of the companies in which we are invested and continue to search for new ideas and investment opportunities while remaining patient and investing only when we believe target companies are trading at attractive prices relative to their intrinsic values.

Sincerely,

Alex Umansky
Portfolio Manager

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