Baron Global Advantage Strategy

BARON CAPITAL

September 30, 2023

Dear Investor:

Performance

Baron Global Advantage Strategy® (the Strategy) lost 5.53% in the third quarter of 2023, which compares to losses of 3.40% for the MSCI ACWI Index (the Benchmark), and 4.89% for the MSCI ACWI Growth Index, the Strategy's benchmarks.

Table I.

Performance for annualized periods ended September 30, 2023 (Figures in USD)†1

	Baron Global Advantage Strategy (net)[2]	Baron Global Advantage Strategy (gross)[2]	MSCI ACWI Index[2]	MSCI ACWI Growth Index[2]
Three Months[3]	(5.53)%	(5.35)%	(3.40)%	(4.89)%
Nine Months[3]	11.64%	12.28%	10.06%	18.16%
One Year	1.60%	2.38%	20.80%	24.41%
Three Years	(13.90)%	(13.21)%	6.89%	3.76%
Five Years	4.06%	4.88%	6.46%	8.37%
Ten Years	9.66%	10.18%	7.56%	9.53%
Since Inception (May 31, 2012)[4]	11.26%	11.73%	9.28%	10.93%

Table II.

Calendar Year Performance 2018-2022 (Figures in USD)

	Baron Global Advantage Strategy (net)[2]	Baron Global Advantage Strategy (gross)[2]	MSCI ACWI Index[2]	MSCI ACWI Growth Index[2]
2018	(3.33)%	(2.78)%	(9.42)%	(8.13)%
2019	45.71%	46.77%	26.60%	32.72%
2020	79.71%	81.19%	16.25%	33.60%
2021	0.86%	1.70%	18.54%	17.10%
2022	(51.70)%	(51.32)%	(18.36)%	(28.61)%

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 increasing. The Strategy gained an additional 6.5% in the month of July, on top of the 16.4% 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. The stage was set for a market pullback due to the combination of $90/barrel oil prices, a growing auto workers strike, the potential for a government shutdown, and rising geopolitical tensions.

For Strategy reporting purposes, the Firm is defined as all accounts managed by Baron Capital Management, Inc. ("BCM") and BAMCO, Inc. ("BAMCO"), registered investment advisers wholly owned by Baron Capital Group, Inc. As of September 30, 2023, total Firm assets under management are approximately $39.6 billion. Gross performance figures do not reflect the deduction of investment advisory fees and any other expenses incurred in the management of the investment advisory account. Actual client returns will be reduced by the advisory fees and any other expenses incurred in the management of the investment advisory account. A full description of investment advisory fees is supplied in our Form ADV Part 2A. Valuations and returns are computed and stated in U.S. dollars. Performance figures reflect the reinvestment of dividends and other earnings. The Strategy is currently composed of a U.S. mutual fund, a SICAV fund, a Collective Investment Trust, and sub-advised accounts managed by BAMCO. The Strategy invests mainly in growth companies of all sizes located throughout the world. BAMCO and BCM claim compliance with the Global Investment Performance Standards (GIPS®). GIPS is a registered trademark owned by CFA Institute. CFA Institute does not endorse, promote or warrant the accuracy or quality of the report. To receive a complete list and description of the Firm's Strategies please contact us at 1-800-99-BARON.

Performance data quoted represents past performance. Current performance may be lower or higher than the performance data quoted. Past performance is no guarantee of future results.

† The Strategy'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 Strategy's level of participation in IPOs will be the same in the future.

1 With the exception of performance data, most of the data is based on a representative account. Such data may vary for each client in the Strategy due to asset size, market conditions, client guidelines, and diversity of portfolio holdings. The representative account is the account in the Strategy that we believe most closely reflects the current portfolio management style for the Strategy. Representative account data is supplemental information.

2 The **MSCI ACWI Index** measures the equity market performance of large and midcap securities across developed and emerging markets, including the United States. The **MSCI ACWI Growth Index** measures the performance of large, mid and small cap growth securities across developed and emerging markets, including the United States. MSCI is the source and owner of the trademarks, service marks and copyrights related to the MSCI Indexes. The indexes and the Strategy include reinvestment of dividends, net of foreign withholding taxes, which positively impact the performance results. The indexes are unmanaged. The index performance is not Strategy performance; one cannot invest directly into an index.

3 Not annualized.

4 The Strategy has a different inception date than its underlying portfolio, which is 4/30/2012.

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

	Quarter End Market Cap (billions)	Percent Impact
Rivian Automotive, Inc.	$23.0	0.61%
argenx SE	28.8	0.57
Endava plc	3.3	0.55
Bajaj Finance Limited	57.0	0.35
MercadoLibre, Inc.	63.5	0.32

From a performance attribution perspective, sector allocation detracted 1.74% from the Strategy's relative results during the third quarter as compared to the MSCI ACWI, whereas stock selection detracted 0.94%. Consumer Discretionary, Information Technology (IT), and Industrials were our three best sectors, generating 2.63% of relative gains. However, these gains were more than offset by poor returns in Financials (**Adyen** and **Block**) and Materials (**Farmers Business Network**), which cost us 4.03% combined. Not having investments in Energy stocks, which was by far the best sector in the benchmark (up 10.7%) and being underweight Communication Services (the second best sector) detracted an additional 0.90% from our relative results.

From a geographical perspective, our performance in emerging markets was positively influenced by our stock selection, mainly driven by our investments in companies like **Afya** in Brazil and **InPost** in Poland. Our investments in companies such as **MercadoLibre** and **Globant** in Argentina also made a notable contribution to our relative performance.

However, these gains were offset by our investments in developed markets, particularly in the United States and the Netherlands, which significantly detracted from our results. While our holdings in the United Kingdom and Israel did have a positive impact, their contributions were not substantial enough to compensate for the weaker performance in other regions.

At the company level, we had 16 contributors and 22 detractors. Among our largest contributors, Rivian, argenx, Endava, Bajaj, MercadoLibre, NVIDIA, and CrowdStrike each made substantial individual contributions to our absolute returns, collectively totaling 3.00%. On the other hand, our two largest underperformers, Adyen and Farmers Business Network, resulted in a 3.90% loss for our strategy. The other seven detractors, each causing a reduction of 0.30% or more, amounted to a further 4.66% decrease in returns. Adyen, the leading European payments processing platform, reported decelerating growth amid increasing competitive intensity in the U.S. online market segment, and the stock declined 59%. While the United States represents a relatively small portion of the company's overall business, estimated at approximately 20%, it remains a crucial market for future growth. We retained a small position and continue to reassess our thesis, though our conviction in this company has clearly been shaken. Farmers Business Network, a private company that provides a two-sided marketplace for farmers and agricultural data and supplies, had a negative development during the quarter as a result of increasing pressures on the business's agricultural inputs segment following the supply-chain imbalances that started to unwind post-COVID. The company completed a new round of financing during the quarter. We chose not to participate in this round, which caused us to revalue the price of stock significantly lower.

Upon closer examination, it is evident that the foundational aspects of the companies in which we are invested remain steadfast and stable.

We believe that most of the underperformance in the third quarter could be explained by several company-specific issues (e.g., Adyen and Farmers Business). At the portfolio level, the positive fundamental trends we noticed in the second quarter continued into the third quarter as well – many of our companies are reporting stability or slight improvement in business trends.

We extensively covered NVIDIA earlier this year, and it's noteworthy that the company has consistently outperformed its own projections and even the most optimistic expectations of Wall Street. In the previous quarter, NVIDIA raised its revenue guidance for 2023 by 40% and its EPS guidance by 69%. In its most recent report, the company then increased these figures further, by 26% for revenue and 35% for EPS. As per consensus expectations, revenues are now projected to grow by 94% this year, while earnings per share are anticipated to increase by an impressive 192%. Despite some skeptics questioning the accelerating demand for generative artificial intelligence (AI), NVIDIA remains unfazed.

Returning to our portfolio, profit expectations have escalated even more rapidly than revenues. During the third quarter, they surged by 11% (or 7.8% excluding NVIDIA), with margin expectations increasing by 1.49% (1.07% excluding NVIDIA). In summary, our portfolio companies are experiencing improvements in their overall business trends, leading to enhanced profitability as reflected in 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, enhancing customer loyalty and granting them pricing power.

But multiples took another leg down…

While fundamentals seem to have turned the corner, the Strategy's holdings experienced a multiple contraction of 9.5% during the third quarter 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 their 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 from houses to 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%. Recession is far from a foregone conclusion, the Fed has likely threaded the

needle and engineered a soft landing. While we do not align with either viewpoint, it's important to note that if the bearish predictions materialize and the economy enters a recession, the Fed is likely to respond by lowering rates sooner and with more aggressiveness. On the other hand, if the optimistic outlook prevails, it's probable that inflation will persist, resulting in longer periods of elevated rates than what investors are presently factoring into their expectations. This logic is inherently circular, as each argument leads into and reinforces the other, allowing both sides to maintain their positions.

The correction was especially pronounced in small and mid-caps as index returns have been driven by mega caps.

As of the end of the third quarter, the "Magnificent Seven" continued to lead the Benchmark's returns – Amazon, Alphabet, Meta, Apple, Tesla, NVIDIA, and Microsoft were up on average **87.8%** year-to-date, contributing **62%** of MSCI ACWI's total return. Small-cap growth stocks continued to underperform with the Russell 2000 Growth Index up a meager **5.2%** year-to-date compared to a **13.1%** gain for the S&P 500 Index, and **25.0%** increase for the Russell 1000 Growth Index. Similarly, within MSCI ACWI, while mega-caps were up 17.2% year-to-date and large caps were up 4.5%, mid-caps were up only 2.6% and *small caps were down 5.3%*. The underperformance of small caps was even more pronounced over the last three and five years where the Russell 2000 Growth Index was up 3.3% compared to gains of 33.7% for the S&P 500 Index, and 25.9% for the Russell 1000 Growth Index.

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, have low or no debt so they are not highly leveraged, have high returns on invested capital, and, historically, they have always used recessions and economic turmoil to their advantage. As their competitors and the upstarts struggle and are forced to pull back because they're fighting for survival, the leaders take market share, consolidate power, and often emerge even stronger than they were before. Small-cap stocks tend to do better when investors' time horizons expand, along with their risk tolerance and appetites, which then show up in stock multiples. It is also worth noting 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.

Within our holdings, we only possess two of the "Magnificent Seven" – Tesla and NVIDIA. Over the past two years, with the underperformance of small-cap stocks becoming more evident, we adjusted our investments by reducing positions in large and mega-cap stocks and increasing our exposure to small and mid caps. This shift was not driven by a top-down approach, as we are fundamentally driven investors. Instead, the evolving market conditions and the disproportionate contraction in valuations of many of our small and mid-cap holdings led us to conclude that they began to present more attractive long-term risk-reward profiles. To fund these adjustments, we used the majority of our large and mega-cap holdings as sources of capital. As of the end of the quarter, the Strategy was positioned with a 19% overweight allocation to small and mid-cap stocks. While this shift has impacted our short-term results, we believe it positions us favorably for the long term.

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 refrain from sector rotation, transitioning to cash positions, or investing in subpar businesses for two primary reasons. First, such actions fall outside our area of expertise. Second, we firmly believe that by consistently investing in high-quality businesses over the long haul, we can surpass index performance, even if it means enduring 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 it is 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. As the holding period extends, the significance of changes in multiples diminishes. This is because multiple changes follow a linear pattern, whereas fundamentals compound exponentially. The 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 traveled to Japan and Korea and met with half a dozen companies. Though we were mostly searching for new ideas, the company that impressed us the most, that we decided to allocate fresh capital to, was one that we already owned.

Coupang is a leading Korean e-commerce company founded in 2010. It went public in March of 2021, and we have been investors in this business since the IPO. 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. These faster delivery times drive customer satisfaction, which translates to higher customer retention rates and lifetime value. We believed that Coupang would continue to increase its market presence within the vast $500 billion Korean retail market in the United States. Simultaneously, it would diversify its product categories, broaden its ecosystem by introducing a third-party marketplace, and make ongoing investments in infrastructure density. These efforts were aimed at capturing inefficiencies, enhancing the overall customer experience, and ultimately improving profit margins. The company has exceeded our expectations by achieving a 25% market share, making it the top player in its industry, even though it wasn't the first to enter the market. Moreover, it

has developed an unparalleled user experience, with 99.8% of products being delivered the next day, and it has achieved profitability much quicker than we initially anticipated. Our biggest takeaway was that, despite all of Coupang's success, there is still a long runway of growth ahead. For instance, during our facility tour, we observed that most of the operation involves manual pickers retrieving items from shelves for orders. However, in one specific area, shelves autonomously moved towards the pickers, mounted on self-driving robots, resulting in a threefold increase in picker productivity. Furthermore, while Coupang has been diligently working to reduce its dependency on third-party distributors, which enables them to enhance profit margins while reducing consumer prices, there remains a substantial opportunity for further reduction.

We also witnessed numerous innovative solutions within the company, such as the singulation process that improves picking efficiency by reducing the need to search for items. Coupang has notably reduced the use of packaging boxes, with 80% of shipments now being boxless. Additionally, its streamlined supply chain allows for grocery delivery without cold-chain logistics. Notably, Coupang efficiently loads its trucks, enabling each to carry over twice the number of parcels compared to UPS or FedEx, despite being smaller in size. The company's 4% free cash flow (FCF) yield, while impacted by substantial reinvestments into emerging offerings, also played a role in our decision to increase our investment in the firm.

Shares of **Rivian Automotive, Inc.**, a U.S.-based electric vehicle manufacturer, continued their volatile trading, and after declining during the first half of 2023, rose 45.7% 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 26.4% 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 thrombocytic 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.

Endava plc provides outsourced software development for business customers. Shares rebounded 10.7% in the third quarter following a prolonged period of weak performance. Macroeconomic uncertainty has weighed on client demand and revenue growth in recent quarters, but management expects growth to improve early next year as several large new projects ramp up. Margins should expand alongside faster revenue growth as the company leverages upfront costs to build capacity in anticipation of an expected recovery. The company is also investing in AI-based tools that can accelerate project timelines and provide additional customer value. We remain shareholders because we believe Endava will continue gaining share in a large global market for IT services as digitization only becomes more important for customers to sustain their competitive positioning and take advantage of the advancements in AI.

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

	Quarter End Market Cap (billions)	Percent Impact
Adyen N.V.	$22.9	–1.98%
Farmers Business Network, Inc.	–	–1.93
Shopify Inc.	70.1	–0.91
Schrodinger, Inc.	2.0	–0.77
Think & Learn Private Limited	–	–0.71

Adyen N.V. provides technology that enables merchants to accept electronic payments. Shares declined 59.1% 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.

Farmers Business Network, Inc. is a private company seeking to create a two-sided marketplace to connect farmers and agricultural data and supplies. By leveraging its technology and community, it is seeking to disrupt large global agricultural markets dominated by oligopolistic counterparties that control distribution channels. Farmers Business Network is a young business that is still consuming cash as it is under scaled, and in investment mode. Furthermore, the company has faced various challenges recently due to internal execution issues amid increasing pressures on the business's agricultural inputs segment following the supply-chain imbalances that intensified during COVID. During the quarter, the company closed a new funding round with terms that reduced the value of our holding, since we decided not to participate.

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 15.5% on the back of rising concerns related to the health of the consumer and the expansion of TikTok and Temu 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.

Portfolio Structure

The portfolio is constructed on a bottom-up basis, with the quality of ideas and conviction level having the most significant roles in determining the size of each investment. Sector and country weights are an outcome of the stock selection process and are not meant to indicate a positive or a negative view.

As of September 30, 2023, the top 10 positions represented 57.8% of the Strategy, and the top 20 represented 82.9%. As we articulated earlier in the year, we have now returned to a more concentrated portfolio as the market volatility enabled us to consolidate the portfolio on our highest conviction ideas (top 10 and top 20 positions were 45.9% and 73.0% in December 2022, and 42.5% and 61.9% in December 2021, respectively). We ended the quarter with 36 investments (down from 41 at the end of December 2022).

Our investments in the IT, Consumer Discretionary, Industrials, Financials, and Health Care sectors (as classified by GICS) represented 99.2% of the Strategy's net assets. Our investments in non-U.S. companies represented 53.6%, while emerging markets represented 18.6% of net assets. An additional 10.9% was invested in companies based in Argentina, which falls outside of MSCI's developed/emerging/frontier markets framework.

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

	Quarter End Market Cap (billions)	Percent of Net Assets
NVIDIA Corporation	$1,074.4	9.3%
MercadoLibre, Inc.	63.5	8.8
Shopify Inc.	70.1	5.8
Endava plc	3.3	5.5
Snowflake Inc.	50.4	5.4
Bajaj Finance Limited	57.0	5.1
Tesla, Inc.	794.2	4.7
Coupang, Inc.	30.3	4.7
argenx SE	28.8	4.7
Cloudflare, Inc.	21.1	3.7

Table VI.
Percentage of securities by country as of September 30, 2023

	Percent of Net Assets
United States	45.7%
Argentina	10.9
India	9.0
Netherlands	8.7
Canada	5.8
United Kingdom	5.5
Korea	4.7
Israel	3.3
Poland	2.1
Brazil	1.6
China	1.3
Spain	0.7

Recent Activity

During the third quarter, we sold two investments – the B2B sales software and data platform **ZoomInfo** and the health care software provider **Veeva**. We also reduced 18 existing positions to raise capital for investor redemptions as well as to add to five names in which we increased our conviction level, since we believe they offer an attractive long-term risk/reward profile: **Wix**, **Coupang**, **argenx**, **Cloudflare**, and **Fiverr**.

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

	Quarter End Market Cap (billions)
Wix.com Ltd.	$ 5.2
Coupang, Inc.	30.3
argenx SE	28.8
Cloudflare, Inc.	21.1
Fiverr International Ltd.	0.9

Our biggest add in the quarter was **Wix.com Ltd.** Wix provides a cloud-based software to help micro-businesses build and maintain websites. We have been investors in Wix since 2017, and despite decelerating sales growth due demand pulling forward during the early days of COVID, which has impacted the share price, we believe the company is making significant progress towards profitability and expanding its opportunity in the partners (professional website development) segment. After years of penalizing near-term profitability with investments in sales and marketing, the company is now taking advantage of its leading brand name to acquire incremental users mostly organically, which enabled it to improve non-GAAP operating margins by 21% year-over-year to 18% for the most recently reported quarter. During its Investor Day, the company further guided to FCF margin targets of 19% in 2024 and 25% in 2025, which we believe could prove conservative as the mix of revenues shifts over time to the partners segment, which is structurally more profitable than the do-it-yourself segment. This is namely because Wix only needs to acquire a partner once, while the partner serves as an external sales force for Wix, creating a highly effective subscriber acquisition channel. Additionally, businesses that hire partners tend to have less churn, have higher business volumes, and adopt additional modules from Wix to drive higher revenue per subscription.

While the advancements in AI remain a risk to be cognizant of, we believe Wix will benefit from AI. The company has been investing in AI for over five years now. AI lowers the hurdles for starting new businesses and designing websites (through Wix's AI site generator), which makes existing businesses more successful over time. We believe that Wix trades at an attractive valuation with an FCF yield of over 5% despite profitability being penalized due to reinvestments back into the partners segment, which investors value below zero (masking the profitability of the do-it-yourself segment). As the partners segment becomes profitable over the next few years, we believe Wix's overall FCF will move much higher.

Our second largest addition in the quarter was the Korean e-commerce leader, **Coupang, Inc.** As mentioned earlier, our visit to Korea reinforced our confidence in Coupang's ability to further expand its market share within the Korean e-commerce industry, while still having significant room for increasing profitability.

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.

Our fourth addition during the quarter was to the leading cloud-based networking and software infrastructure, **Cloudflare, Inc.** Despite continued elongation of sales cycles due to the macro slowdown, the company reported signs of stabilization and noted that the second quarter set a new record for pipeline generation, while deal close rates are improving and sales representative productivity is also moving in the right direction after the go-to-market changes the company implemented in the first quarter.

Our last addition during the quarter was to the leading freelance platform, **Fiverr International Ltd.** The company's revenue growth rates remain negatively impacted by macro factors as it's relatively easy for customers to hire fewer freelancers when they must cut budgets in the near term. However, we are encouraged by the company's rapid progress on the profitability front (with guidance for EBITDA margins to be approximately 16% for 2023 compared to 7% in 2022), early signs of revenue growth acceleration, and its significant long-term opportunity as freelance work continues growing. These factors present a positively skewed risk/reward opportunity for long-term investors, especially with the shares trading at a 9% FCF yield. We have therefore decided to add to our position.

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

	Quarter End Market Cap or Market Cap When Sold (billions)
CrowdStrike Holdings, Inc.	$40.0
ZoomInfo Technologies Inc.	7.5
Veeva Systems Inc.	32.7
Datadog, Inc.	29.6
Adyen N.V.	22.9

Outlook

It appears that financial commentators have shifted their focus from the question of "how high can interest rates rise?" to "how long will rates need to remain at these elevated levels?" The bond market has clearly moved in that direction with the 10-Year U.S. Treasury bond yield increasing from 3.81% as of the end of the second quarter to 4.80% at the end of the third. This increase in rates has had a significant impact, causing the Vanguard Long-Term Bond ETF to experience a 14% decline from the start of the quarter through mid-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 the 10-Year TIPS) have risen all the way up to 2.3%. We understand why long-duration assets are selling off in a scenario where rates stay higher for an extended period, but we are uncertain about the sustainability and persistence of this trend. We believe that the consensus view regarding higher interest rates has already shifted towards the expectation of not much more increase, and we anticipate that the duration of these elevated rates will not extend for much longer. In other words, we expect this period to be measured in months or quarters, rather than years. For our purposes, this is considered a relatively short duration.

It also never ceases to amaze 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 report was published on October 3, showing that the economy had 9.6 million job openings, which was more than consensus estimates, the market sold off, with the S&P 500 Index losing 1.4% and the Russell 2000 Growth Index down 1.8%. This move was consistent with the *higher-for-longer* narrative, and the 10-Year Treasury yield did increase in response to the news. Then, on 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 S&P 500 Index went straight up that day, closing with a 1.2% gain, while the Russell 2000 Growth Index finishing the day up 1.1%, with what looked to us like similar and consistent data causing the exact opposite effect on market movement and the prices of our stocks.

Every day, we live and invest in an uncertain world. Well-known conditions and widely anticipated events, such as Federal Reserve 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 the target companies are trading at attractive prices relative to their intrinsic values.

Sincerely,

Alex Umansky
Portfolio Manager

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