LINDA MARTINSON
CHAIRMAN, PRESIDENT AND COO

The first three months of 2024 brought robust returns to U.S. and global equity markets, adding to the strong results from the prior quarter. The cumulative increases over the past two quarters elevated popular U.S. equity indexes, such as the S&P 500 Index and the Russell 3000 Index, to new all-time highs. Stocks were largely buoyed by ongoing economic resilience, a surge in positive sentiment surrounding advancements in artificial intelligence (AI), and the prospect of lower interest rates, although not as soon as initially expected.

New market peaks, however, should not be mistaken for peaking markets. All-time highs occur more frequently than one might expect. Since 1960, the S&P 500 Index has reached an all-time high 25% of the time, measured using month-end data. The Russell 3000 Index has done so 29% of the time since 1979, when index data first became available. Therefore, these peaks are not uncommon and do not mark something highly unusual. However, as markets continue to push to new heights, inefficiencies and dislocations begin to develop – conditions that create prime opportunities for active managers to demonstrate their value.

"We tend to overestimate the effect of a technology in the short run and underestimate the effect in the long run." This observation, known as Amara's Law, was made by American scientist and futurologist Roy Amara in the 1960s. Its relevance appears strikingly profound in today's financial landscape, especially in the context of the growing interest in generative AI and the ensuing buildup in investor excitement and expectations. While it is still hard to tell whether investors are expecting too much from AI in the near term, the attention to and the performance of key technology stocks suggests that market dynamics are currently aligning with this hypothesis.

The excessive focus on a small number of companies connected to the AI theme may be preventing investors from seeing a broader, long-term picture and from getting exposure to other attractive growth opportunities. This is particularly valid for passive equity investors who are exposed to the large bias of the popular equity indexes to a handful of stocks – something that we have addressed in the past and that has been broadly covered by financial media and commentators.

In the last quarter of 2023, the Russell 3000 Index returned 12%, with nearly one-third of this performance driven by six stocks of the Magnificent 7[1], recognized as pioneers in AI and some of the biggest beneficiaries of AI advancements. Moving into the first quarter of 2024, the Russell 3000 Index gained another 10%, with five stocks of the Magnificent 7 accounting for nearly half of this increase. These meaningful contributions to index performance were a function of solid stock returns but also of the significant weights these stocks have accumulated in the indexes. When there is concentration of momentum within a small number of stocks with material index weights, this tends to drive market cap outperformance. An analysis of longer-term historical data shows that this tends to be temporary, and that market cap outperformance and equal weight outperformance move in cycles.

The most popular stock market indexes, including the S&P 500 Index and the Russell 3000 Index, are market cap weighted. A market cap weighted index assigns larger weights to the stocks with larger market capitalization. When larger companies make up a bigger portion of the index, they are more likely to have a greater impact on its performance. On the other hand, each company included in an equal weight index is assigned the same weight, regardless of the company's size, market capitalization, or other characteristics. This can provide a clearer view of the market's overall performance.

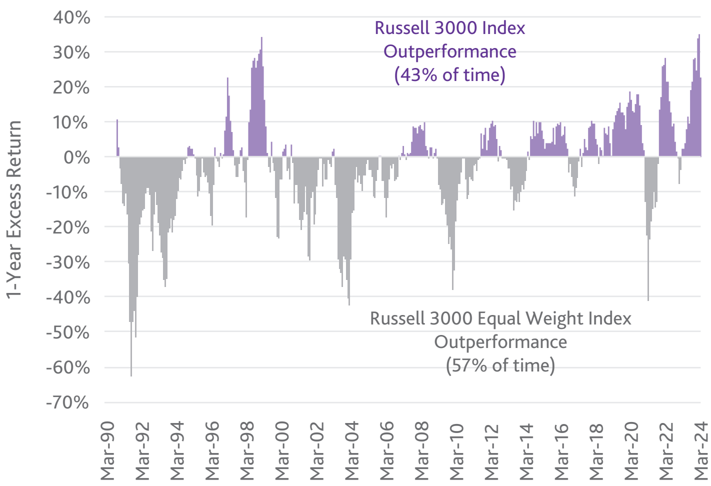
The chart on the next page shows the rolling one-year excess return of the Russell 3000 Index versus its equal-weight counterpart. More recently, the market-cap weighted Russell 3000 Index has been outperforming significantly, by amounts comparable only to those in the late 90s.

[1] *The group of stocks referred to as the Magnificent 7 consists of Microsoft Corp., Apple Inc., NVIDIA Corp., Alphabet, Inc., Amazon.com, Inc., Meta Platforms, Inc., and Tesla, Inc. In 2023, all of these stocks performed significantly better than the general stock market, which earned the group that name.*

Market Cap Weighted Indexes Don't Always Outperform

Rolling One-Year Excess Return of the Russell 3000 Index vs. the Russell 3000 Equal Weight Index*

1/31/1990 - 3/31/2024



Sources: FactSet, Baron Capital.

** The Russell 3000 Equal Weight Index is not an actual index and is not part of the FTSE Russell family of indexes. In the above analysis, the Russell 3000 Equal Weight Index reflects the hypothetical performance of the Russell 3000 Index if each index constituent carried the same weight. The performance was measured by calculating the average return of the index constituents, daily, and then chain-linking the average returns to calculate rolling one-year performance. The performance data quoted represents past performance. Past performance is no guarantee of future results. Index performance is not Fund performance. Investors cannot invest directly in an index.*

Historically, such significant divergence in performance has always subsided and reverted. We have no reason to believe this time will be different. It's important to note that this doesn't necessarily imply a market pullback. Instead, for the effects of concentration to dissipate, it would be sufficient to see improved performance across a broader array of stocks. We believe that this broadening of market performance is already underway.

As shown in the next table, in Q1'24, NVIDIA Corp. was the largest contributor to the performance of the Russell 3000 Index, with an impressive three-month return of 82.46%. Despite this standout performance, 37 of the nearly 3000 index constituents outperformed NVIDIA Corp. during the quarter. Additionally, 846 index constituents outperformed the second largest contributor, Microsoft Corp., which returned 12.09%. And a total of 972 index constituents, representing 33% of all constituents, outperformed the index itself.

The Stocks That Drove Q1'24 Market Returns Were Not Necessarily the Best Performers

Top 10 Contributors to the Performance of the Russell 3000 Index in Q1'24

#	Company Name	Index Weight as of 3/31/24	Total Return	Contribution to Index Return	# of Stocks in the Index with Better Performance
1	NVIDIA Corp.	4.23%	82.46%	2.15%	37
2	Microsoft Corp.	6.17%	12.09%	0.77%	846
3	Meta Platforms, Inc.	2.12%	37.33%	0.67%	171
4	Amazon.com, Inc.	3.20%	18.72%	0.56%	525
5	Eli Lilly and Co.	1.30%	33.69%	0.37%	203
6	Alphabet, Inc.	3.27%	8.05%	0.27%	1087
7	Berkshire Hathaway, Inc.	1.52%	17.91%	0.26%	568
8	Broadcom, Inc.	1.13%	19.23%	0.21%	511
9	JPMorgan Chase & Co.	1.14%	18.48%	0.19%	540
10	Exxon Mobil Corp.	0.92%	17.35%	0.14%	597
	Top 37 Index Stocks by Total Return	0.22%	82.7% to 473.5%	0.14%	
	Russell 3000 Index		**10.02%**		**972**

Source: FactSet.

The performance data quoted represents past performance. Past performance is no guarantee of future results.

This data clearly shows that strong performance has not been limited to just a handful of stocks, and that there is a distinct opportunity for active managers to showcase their skill.

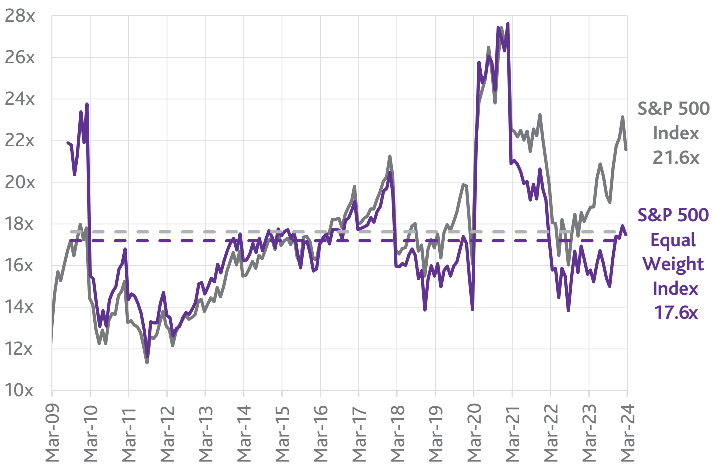
The higher dispersion among stocks is additionally evident in valuations. As the charts on the next page show, the range of stock valuations has been expanding recently. While some stocks may have become too richly valued, there remain a significant number of companies with more attractive valuations.

The first chart illustrates the one-year forward price-to-earnings (P/E) ratios of the S&P 500 Index and the S&P 500 Equal Weight Index, along with their long-term averages. Since 2009, when data for the S&P 500 Equal Weight Index first became available, the valuations of the two indexes have generally remained closely aligned. This suggests that, historically, investors have not consistently favored either the larger or smaller companies within the S&P 500 Index. However, more recently, we have observed a significant divergence, with the P/E ratio of the S&P 500 Index rising faster than that of the S&P 500 Equal Weight Index. This divergence points to some of the larger companies gaining a higher valuation relative to the broader market, a trend underscored by the S&P 500 Index's P/E ratio surpassing its 15-year average by a substantial margin, while the S&P 500 Equal Weight Index's valuation remains only moderately above its typical level. Our interpretation of this data: while overall valuations have risen, the increase is most pronounced among some of the largest cap stocks. Meanwhile, a multitude of smaller-sized companies are trading at considerably more reasonable valuations.

Mega Caps Have Caused Significant Dispersion in Valuations

Price-to-Earnings Using FY1 Earnings Estimates

As of 3/31/2024



Source: FactSet.

Note: FY1 estimates reflect the Street's expectations for a company's earnings per share over the next fiscal year.

The breadth of the market's valuation landscape is further illustrated by the subsequent charts, which depict P/E and price to sales (P/S) ratios across different market cap segments, based on one-year forward earnings and sales estimates.

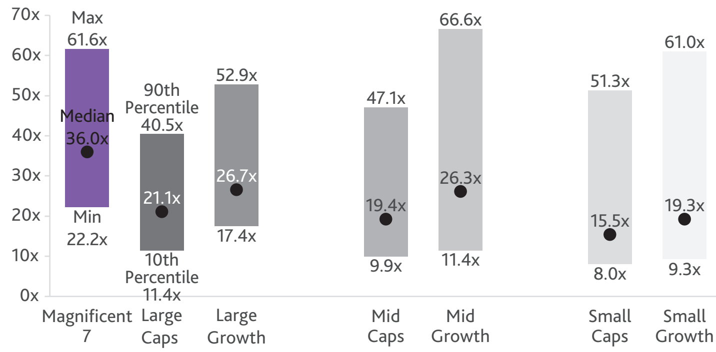
The first chart details the P/E ratios for large, mid, and small cap segments, alongside their respective growth categories, and the valuation spread of the Magnificent 7. Each bar, aside from the Magnificent 7, represents the valuation spectrum within each segment, with the 10th and 90th percentiles indicating the lowest and highest values, respectively, and the median highlighted for comparison. The Magnificent 7's valuation range is defined by the lowest and highest multiples in the group.

Key observations include: (i) the Magnificent 7 exhibit not only the highest median P/E and highest minimum, but also a remarkable variance within their valuations; (ii) larger cap stocks generally command higher median P/Es; and (iii) there is a notable spread in P/Es within each market cap category, more pronounced among smaller caps. Growth stocks reflect similar trends, with even wider valuation ranges, signaling potentially better opportunities for active investors in that segment.

There Is a Significant Dispersion of Valuations Across the Market Cap Spectrum

Price-to-Earnings Using FY1 Earnings Estimates

As of 3/31/2024



Source: FactSet.

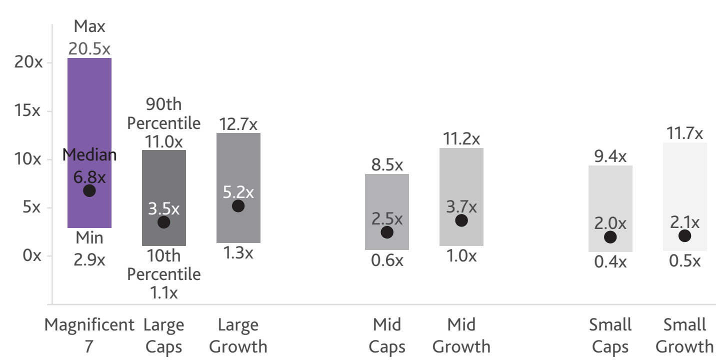
Note: The market cap categories in the charts above and below are represented by the following indexes: Large Caps by the Russell Top 200 Index, Large Growth by the Russell Top 200 Growth Index, Mid Caps by the Russell Midcap Index, Mid Cap Growth by the Russell Midcap Growth Index, Small Caps by the Russell 2000 Index, and Small Cap Growth by the Russell 2000 Growth Index.

Note: FY1 estimates reflect the Street's expectations for a company's earnings per share over the next fiscal year.

Equally telling is the second chart, which presents the P/S ratios across the market cap spectrum. A similar pattern emerges, with Magnificent 7 and larger growth stocks commanding higher sales multiples, a possible indication of investor expectations for substantial future revenue growth. Yet, this enthusiasm does not seem to extend uniformly across the market, as evidenced by the lower P/S ratios seen in smaller cap stocks. This disparity in sales valuation, particularly at the median and 10th percentile levels, offers a compelling narrative: there seems to be a segment of the market that may be overlooked by investors flocking to larger, more popular names.

Price-to-Sales Using FY1 Sales Estimates

As of 3/31/2024

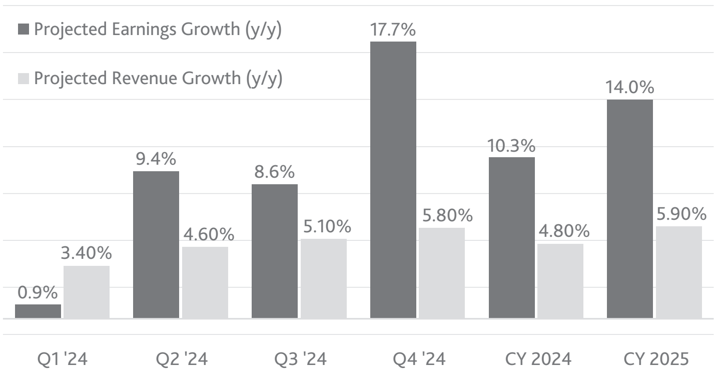


Source: FactSet. Note: FY1 estimates reflect the Street's expectations for a company's sales over the next fiscal year.

While valuation multiples have trended up in the past few months, we believe they largely remain supported by strong and improving fundamentals. As the next chart shows, earnings per share and revenues are generally expected by the Street to keep improving throughout the year and in 2025.

The Street Expects Corporate Revenues and Earnings to Improve in 2024 and 2025

Projected Earnings Per Share and Revenue Growth for the S&P 500 Index



Source: FactSet Earnings Insight from 4/12/2024.

This underpinning of stable growth rates sets the stage for what we expect may be a strong market for the rest of the year. Nevertheless, the performance and valuation dispersion of equities beyond the Magnificent 7 indicates a potential shift in how market leadership may unfold. In addition, the prospect of lower interest rates, persistent geopolitical volatility, and the upcoming U.S. presidential elections, present a complex backdrop and a potentially more intricate investment environment for investors to navigate. In our view, these varying market conditions favor the agility inherent in active management.

Returning to Amara's Law, it is the part about underestimating technology's long-term impact that captures our attention. In our view, people's tendency to underestimate long-term effects extends beyond technology. For example, the long-term potential of growth is frequently underestimated. This common oversight stems from a fundamental misunderstanding of how compounding can exponentially influence growth over extended periods, and a prevalent focus among investors on short-term earnings. Long-term compounding is crucial for long-term investing, particularly in growth stocks where investments in research and development and capital expenditures (e.g., building production facilities or buying equipment) may not provide immediate returns but are vital for sustained growth. Such investments often go underappreciated because they may temporarily impact earnings. We actively seek out these companies, convinced of their potential to outperform the market over the long term.

Our research team puts a significant emphasis on the importance of exceptional management teams and their commitment to long-term growth. We believe that strong, visionary leadership is crucial for transforming potential into success and navigating companies through market and technological changes. At the same time, we aim to make our investments at attractive valuations, which provide a safety margin and enhance the potential for superior returns. These four pillars – long-term growth potential, durable competitive advantages, high-quality management, and attractive valuations – are the fundamental components of our growth investing strategy at Baron Capital.

The exposures of the Baron Funds to different types of growth stocks vary widely based on the range and availability of opportunities in each Fund's investment universe, investment strategy objectives, and the risk appetites of the portfolio managers. Broadly speaking, our investments fall within stable growth or high/disruptive growth. The companies that we consider stable growth tend to be high-quality, well-established businesses with strong competitive advantages. These firms boast robust business models, often featuring high recurring revenues, attractive incremental margins, and strong cash generation capabilities. Many firms we initially invested in as smaller enterprises have matured into stable, core growth investments.

Our high/disruptive growth investments are aimed at innovative companies that are leading transformations within their industries. These companies are marked by their rapid scalability in large and expanding markets and are pioneers in or are driven by significant secular trends. We believe these businesses offer greater growth potential, albeit with more risk relative to other investments.

In connection with our long-term approach to investing, our research team looks for secular growth trends that represent transformative shifts that reshape industries and drive sustained economic progress. Within these secular growth trends, we identify themes that we believe provide the most attractive long-term opportunities.

One of the tech-related secular growth trends that we are investing in focuses on advancements in AI and machine learning (ML). While AI and ML have been focal points for our research team for years, we believe that these technologies are still in the early days of development. Recent breakthroughs have underscored their significant potential to disrupt entire industries and create substantial business value.

We view generative AI as the next major secular tectonic shift, like cloud platforms, and the most compelling force to power technology innovation and impact human life over the next decade. We believe it will disrupt many industries, strengthening some businesses and weakening others. In addition to semiconductor companies, we expect companies in systems software, autonomous driving, and business application software, along with investors in generative AI themselves, to benefit. For more of our thoughts on AI investing, please read our most recent publication on the subject *Agent Ascendancy: GenAI's Future Frontliners in Large-Scale Consumer Applications*.

An example of a secular growth trend in the Health Care sector where we are finding investment opportunities is treatment for the increasing number of obese and diabetic people. For years, medical technology and pharmaceutical companies have been developing innovative devices and drugs that can help people manage their blood sugar and lose weight. Last year, a new class of weight loss drugs (GLP-1s) gained significant popularity, after showing significant potential to mitigate these conditions and the health issues that accompany them. According to scientists, these drugs have been shown to reduce weight by 15% to 20%, with few major side effects or safety concerns. We think people will be motivated to try GLP-1s for health, lifestyle, and aesthetic reasons. Over time, we expect this space could represent the largest growth opportunity in the history of health care, one in which multiple players can win. For more of our thoughts and ideas on the subject, please read *INSIGHTS: A Multi-Billion-Dollar Drug Market*.

The technology-driven secular changes in the financial industry have been another source of investment ideas for Baron Capital. The global shift from cash to electronic payments, the growing demand for data to inform decision-making, and the electronification of capital markets are three of several fintech trends we have been actively exploring. For more details on our investment approach in the fintech space, please read *The FinTech Revolution: The Future of Finance*.

Despite the turbulent markets of the last few years, our long-term view on the U.S. and global economies remains optimistic. Our investment style has not changed, and neither has our outlook. We do not know, nor are we trying to guess, if 2024 will be more like last year or some other time in history. Our attention and efforts remain firmly focused on the long run. With so many things changing around us, we are highly confident that these are opportune times for active long-term investors to capitalize on market inefficiencies and dislocations. We remain committed to uncovering the best long-term opportunities for our investors.

Sincerely,

Linda S. Martinson
Chairman, President, and COO

Risks: All investments are subject to risk and may lose value.

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 document reflect those of the respective writer. 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.

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Price/Earnings Ratio or P/E (next 12-months): is a valuation ratio of a company's current share price compared to its mean forecasted 4 quarter sum earnings per share over the next twelve months. If a company's EPS estimate is negative, it is excluded from the portfolio-level calculation. **Price/Sales Ratio** is a valuation ratio of a stock's price relative to its past performance. It represents the amount an investor is willing to pay for a dollar generated from a particular company's operations.

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