



## Ron, Michael, and David Baron: Investing in Long-Term Secular Growth with Conviction

This is an edited version of a February 2, 2023, webinar with Ron Baron, Michael Baron, and David Baron. Ron is CEO of Baron Capital and portfolio manager of Baron Partners Fund and Baron Focused Growth Fund, as well as Baron Growth Fund and Baron WealthBuilder Fund, which he discusses in a separate webinar. Michael is portfolio manager of Baron Partners Fund as well as Baron WealthBuilder Fund. David is portfolio manager of Baron Focused Growth Fund. To access the video recording, please visit [our website](#).

### Executive Summary

- While everyone seems to have a negative outlook these days, we remain optimistic. In our many decades of investing, there has always been bad news. At the same time, the U.S. economy has continued to grow, and the stock market has grown even faster.
- We think many of our stocks are cyclically and not secularly depressed, and we are seeing opportunities to buy them at attractive prices.
- In our experience, high-growth companies that constantly invest in themselves, the type of companies we favor, tend to grow in any type of market.

### *Ron, what gives you confidence to stay the course when growth is deeply out of favor?*

**Ron Baron:** Our process, our proprietary research, and our experience. We trust our approach, our ability to identify competitively advantaged businesses, run by exceptional people, positioned to drive, or benefit from secular growth trends and grow for many years.

It seems that everyone has a negative outlook these days. They think we're going into a recession and the war in Ukraine will last forever. In the 52 years of my career, there's only been one year where the news was consistently good for the whole year. That was 1989 when the Berlin Wall came down. The world thought there would be a big peace dividend where we could invest money spent on defense on consumer products instead, and we were going to have a boom. Since then, news cycles have been dominated by wars, pandemics, threats to democracy, financial panics, market crashes, oil shortages, riots, and terrorism. We don't believe anyone can predict such things or how they will affect the stock market or the economy in the short term, and we don't try either.

At the same time, when we started Baron Capital in 1982, the Dow was around 820. It's now 33,000, so it's up 41 times. With all the bad news, the market's up 41 times. That's because the market tracks our economy, and the economy grows, on average, 7% a year.

Now, inflation is the big concern. We forget that inflation is not unusual. Historically, everything doubles in price, roughly every 14 or 15 years. The stock market has averaged 9% or 10% growth, plus dividends, every year. It doubles about every seven, eight, or nine years. We aim to invest in companies that are doubling in size every five or six years — 15% growers instead of 6% or 7% growers. We might overpay at times but if we can keep doubling our money every five, six, or seven years, we can do better than the

market over the long term.

### *How did Baron Partners Fund weather challenges of 2022?*

**Michael Baron:** The Fund had a tough fourth quarter and a tough year. That's not unexpected for a concentrated, high-conviction growth fund. The portfolio consists of 30 names with the top 10 representing about 83% of total investments. Leverage bottomed in March of 2021 at about 3% to 4% but is now closer to the Fund's historical average at around 20%. While 2022 was a difficult year, long-term performance remains well ahead of its benchmarks, the Russell Midcap Growth Index and the S&P 500 Index. Underperformance in the fourth quarter of 2022 essentially comes down to what happened to **Tesla, Inc.**'s stock price, which declined 53.6% in the fourth quarter.

### *Tesla is the Fund's largest holding. Tell us your thoughts on what happened.*

**Michael Baron:** We started investing in Tesla in 2014 and built the position over a two-year period at an average price of \$14.22. The last time we purchased shares, Tesla stock accounted for less than 10% of the Fund's assets. It grew to become a significant percentage of the portfolio. We are more confident today that Tesla can produce on its mission than when it was only producing 35,000 vehicles per year. In 2022, it produced 1.37 million vehicles.

Several events impacted Tesla in the fourth quarter of 2022.

- CEO Elon Musk acquired **Twitter, Inc.** People had strong opinions about the purchase and Elon's actions and statements related to the purchase and many observers felt that the controversy created a negative connotation for the Tesla brand. We disagree and don't think the Twitter acquisition will hurt demand for Tesla's vehicles over the long term.
- China, a very large market for Tesla, has gone through a difficult time with its zero-COVID policy and the outbreaks that occurred when that policy was abandoned. There was a pause in production and demand. As we saw here in the U.S., we believe China will move beyond the current COVID pandemic and return to a relatively normal way of life.
- We don't predict macroeconomic issues, but we are aware of the looming potential for recession. Consumers already feel it and are tightening their purse strings. However, should it occur, we do not expect a recession to impact our long-term thesis on Tesla. Additionally, the Inflation Reduction Act includes incentives starting in 2023 for consumers purchasing electronic vehicles. That postponed some demand.

All these issues are temporary. We like what is happening fundamentally. Tesla continues to make strides in producing a lower cost vehicle with higher profits. We think Tesla can do well at its current price point and no other company can compete if the price comes down further. We believe savings will be realized from a better battery pack and government incentives for that battery, more efficient manufacturing in terms of labor and casting, and the ramp of new production facilities in Berlin, Germany and Austin, Texas. Tesla is working to make sure demand stays strong and it will be able to meet that demand.

The stock recovered somewhat at the end of 2022 and into 2023. Demand is twice the rate of production and now appears stronger as the situation in China is settling and the Inflation Reduction Act starts to kick in. We think Tesla can grow 50% per year; therefore we predict production can reach two million in 2023.

We sold 4.5 million, or about 27%, of our shares for an average price of \$218. We didn't sell more

because we are confident that the company is just scratching the surface of what it can do, even though it's already grown significantly in both production and value. We never thought the business would achieve 100% market share of electric vehicles, but we do believe it will be much larger than a 1% share. The question is how profitable each vehicle can be. The company is taking steps to lower costs. It also has ancillary services – the battery, the software for autonomous driving, robotics, and casting – it can move into based on its positioning within transportation and energy and battery usage.

#### *Tell us about other notable holdings in the portfolio.*

**Michael Baron:** Even though this is a concentrated fund, we still achieve diversification. We find companies with different end markets and growth trajectories and the ability to grow in different environments. Whether they fit into our Disruptive, Core Growth, Financials, or Real Assets bucket, many of our companies grew faster than their respective indexes. **Arch Capital Group, Ltd.**, a leader in its segment of insurance underwriting, reported premium growth of 26%. **IDEXX Laboratories, Inc.**, a leader in pet testing and diagnostics, is seeing improvement in pricing and test placements, a leading indicator of growth. **Red Rock Resorts, Inc.**, a localized gaming company in Las Vegas, has seen its market return to pre-COVID levels and margins have improvement as a result.

#### *Let's move on to Baron Focused Growth Fund.*

**David Baron:** This Fund also underperformed in the fourth quarter of 2022 due to its large Tesla position, but full-year performance was still in line with its benchmark, the Russell 2500 Growth Index. We think many of our stocks are cyclically depressed, not secularly depressed, and we are seeing opportunities to buy them at attractive prices. Many are pricing in earnings declines for this year. For instance, **PENN Entertainment, Inc.**, Red Rock Resorts, **Marriott Vacations Worldwide Corp.**, and **Vail Resorts, Inc.** are pricing in EBITDA declines. While that could be the case if a recession occurs, we think many are pricing in pretty draconian scenarios.

#### *How are you responding?*

**David Baron:** We've been trying to realize losses for tax purposes, using the cash to upgrade the portfolio. We are focusing on companies in which we have higher conviction based on their strong competitive advantages.

We have not changed how we manage the portfolio and still search for companies that can raise prices every year without impacting retention rates. **FactSet Research Systems, Inc.**, **CoStar Group, Inc.**, **MSCI, Inc.**, and **Arch** are good examples. We also look for companies that can produce goods and services at the lowest possible cost, such as **Tesla** or **Figs, Inc.** In the fourth quarter, we initiated positions in **ANSYS, Inc.** and **IDEXX Labs**, and sold two-thirds of our position in **Spotify, Inc.** to take advantage of losses.

ANSYS provides simulation software for new product development. Companies use ANSYS software for product testing that cannot be done independently. ANSYS generates strong recurring revenue through contracts that last between three and five years with retention rates around 95%.

IDEXX is the dominant market leader in animal health diagnostics with more than 50% market share. It is benefiting from strong long-term secular trends in the veterinary market, including growth in the pet population, humanization of pets, and the growing intensity of diagnostics.

#### *What are companies telling you regarding inflation and fears of recession?*

**David Baron:** So far, our companies are not seeing declines in demand and spending. Many are even seeing rebounds in earnings and cash flow and stronger balance sheets than they had before the

pandemic. Many are using cash flow to fund growth opportunities, buy back stock, and increase dividends. To us, that indicates companies have a positive outlook and see value in their stock.

We've seen estimates that consumers built as much as \$1 trillion in savings over the past three years, which is keeping consumer credit metrics at high levels. As a result, banks are extending more loans which is driving more spending. **Visa, Inc.** recently reported travel and leisure spend that was 12% above 2019 levels in the third quarter and 18% above 2019 levels in the fourth quarter of 2022. This should be a positive for the Fund, since about one quarter of the portfolio is invested in this area. Combine this with about \$2 trillion in private equity capital waiting to be invested, and we think this should be beneficial for our holdings.

Tesla reported strong earnings despite supply chain issues leading to higher inventory levels and global price cuts. The electric vehicle market remains underpenetrated at just 5% of the market, and Tesla continues to have a dominant share.

Travel and leisure companies continue to see earnings above pre-pandemic levels due to more efficient marketing labor costs and higher income consumers. We think these gains are sustainable, with further potential for growth and return of capital by many of these names. Even if a recession does occur, which most of these stocks are already discounting, we believe these companies can still generate earnings above pre-pandemic levels.

#### ***Are rising rates and the risk of recession a concern for you?***

**David Baron:** Historically, the Fund has done well during periods when rates are rising. We think this is the case because we invest in growth companies that constantly invest in themselves. As a result, they continue to grow through any type of market. While we can't predict the future, we believe the earnings worth of our companies should drive performance from here and many of our stocks are already pricing in recession scenarios for earning and cashflow declines in 2023. As I said earlier, our research tells us these stocks are cyclically and not secularly depressed and should recover over the next one to two years. We see significant upside for the Fund in the years to come.

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*Investors should consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus and summary prospectuses contain this and other information about the funds. You may obtain them by calling the fund's distributor, Baron Capital at 1-800-99BARON, or by visiting [www.baronfunds.com](http://www.baronfunds.com). Please read them carefully before investing.*

**Baron Partners Fund's** annualized returns for the Institutional Shares as of December 31, 2022: 1-year, (42.41%); 5-years, 21.98%; 10-years, 19.49%. Annual expense ratio for the Institutional Shares as of December 31, 2021 was 1.11%. The **Russell Midcap Growth Index's** annualized returns as of December 31, 2022: 1-year, (26.72%); 5- years, 7.64%; 10-years, 11.41%.

**Baron Focused Growth Fund's** annualized returns for the Institutional Shares as of December 31, 2022: 1-year, (28.14%); 5-years, 20.94%; 10-years, 15.39%. Annual expense ratio for the Institutional Shares as of December 31, 2021 was 1.05%. The **Russell 2500 Growth Index's** annualized returns as of December 31, 2022: 1-year, (26.21%); 5-years, 5.97%; 10-years, 10.62%.

*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 may reimburse certain Fund expenses pursuant to a contract expiring on August 29, 2033, unless renewed for another 11-year*

*term and the Fund's transfer agency expenses may be reduced by expense offsets from an unaffiliated transfer agent, without which performance would have been lower. Current performance may be lower or higher than the performance data quoted. For performance information current to the most recent month end, visit [www.BaronFunds.com](http://www.BaronFunds.com) or call 1-800-99BARON.*

Performance reflects the actual fees and expenses that were charged when the Funds were partnerships. The predecessor partnerships charged a 20% performance fee (Baron Partners Fund) or a 15% performance fee (Baron Focused Growth Fund) after reaching a certain performance benchmark. If the annual returns for the Funds did not reflect the performance fee for the years the predecessor partnerships charged a performance fee, returns would be higher. The Funds' shareholders are not charged a performance fee.

Performance for the Institutional Shares prior to 5/29/2009 is based on the performance of the Retail Shares, which have a distribution fee. The Institutional Shares do not have a distribution fee. If the annual returns for the Institutional Shares prior to 5/29/2009 did not reflect this fee, the returns would be higher.

**Risks:** The Funds are non-diversified which means, in addition to increased volatility of the Funds' returns, they will likely have a greater percentage of their assets in a single issuer or a small number of issuers, including in a particular industry than a diversified fund. Single issuer risk is the possibility that factors specific to an issuer to which the Funds are exposed will affect the market prices of the issuer's securities and therefore the net asset value of the Funds. As of the date of the latest prospectus supplement, about 49% and 27% of Baron Partners Fund's and Baron Focused Growth Fund's assets are invested in Tesla stock. Therefore, the Funds are exposed to the risk that were Tesla stock to lose significant value, which could happen rapidly, the Funds' performance would be adversely affected. Specific risks associated with investing in small and medium-sized companies include that the securities may be thinly traded and more difficult to sell during market downturns. The Funds may not achieve their objectives. **Baron Partners Fund:** Special risks associated with leverage include increased volatility of the Fund's returns and exposure of the Fund to greater risk of loss in any given period.

The discussion of market trends is not intended as advice to any person regarding the advisability of investing in any particular security. The views expressed in this presentation reflect those of the respective speaker. Some of our comments are based on management expectations and are considered "forward-looking statements." Actual future results, however, may prove to be different from our expectations. Our views are a reflection of our best judgment at the time and are subject to change at any time based on market and other conditions and Baron has no obligation to update them.

The **Russell 2500™ Growth Index** measures the performance of small to medium-sized U.S. companies that are classified as growth. The **Russell Midcap™ Growth Index** measures the performance of medium-sized U.S. companies that are classified as growth. Russell Investment Group is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell is a trademark of Russell Investment Group. The indexes and the Fund include reinvestment of dividends, net of withholding taxes, which positively impact the performance results. The indexes are unmanaged. Index performance is not Fund performance; one cannot invest directly into an index.

**Portfolio holdings as a percentage of net assets\* as of December 31, 2022, for securities mentioned are as follows: Tesla, Inc. – Baron Focused Growth Fund 10.4%, Baron Partners Fund 25.8%; Arch Capital Group, Ltd. – Baron Focused Growth Fund 7.8%, Baron Partners Fund 7.1%; IDEXX Laboratories, Inc. - Baron Focused Growth Fund 1.6%, Baron Partners Fund 5.6%; Red Rock Resorts Inc. – Baron**

Focused Growth Fund 3.3%, Baron Partners Fund 0.8%; **PENN Entertainment, Inc.** – Baron Focused Growth Fund 1.9%; **Marriot Vacations Worldwide Corp.** – Baron Focused Growth Fund 2.3%, Baron Partners Fund 1.6%; **Vail Resorts Inc.** – Baron Focused Growth Fund 5.2%, Baron Partners Fund 4.3%; **FactSet Research Systems, Inc.** – Baron Focused Growth Fund 5.0%, Baron Partners Fund 5.0%; **CoStar Group, Inc.** – Baron Focused Growth Fund 6.2%, Baron Partners Fund 9.8%; **MSCI, Inc.** – Baron Focused Growth Fund 4.8%, Baron Partners Fund 1.6%; **ANSYS, Inc.** – Baron Focused Growth Fund 2.0%; **Spotify Technology S.A.** – Baron Focused Growth Fund 1.1%, Baron Partners Fund 0.3%; **Figs Inc.** – Baron Focused Growth Fund 3.5%, Baron Partners Fund 0.8%.

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

**Baron Focused Growth Fund Top 10 holdings as of December 31, 2022**

Holding	% Assets
Space Exploration Technologies Corp.	11.9
Tesla, Inc.	10.4
Arch Capital Group Ltd.	7.8
Hyatt Hotels Corp.	6.2
CoStar Group, Inc.	6.2
Vail Resorts, Inc.	5.2
FactSet Research Systems, Inc.	5.0
MSCI, Inc.	4.8
Iridium Communications, Inc.	4.5
Figs, Inc.	3.5
Total	65.4

**Baron Partners Fund Top 10 holdings as of December 31, 2022**

Holding	% Assets
Tesla, Inc	25.8
Space Exploration Technologies Corp.	10.2
CoStar Group, Inc	9.8
Arch Capital Group Ltd.	7.1
The Charles Schwab Corp.	5.9
IDEXX Laboratories, Inc.	5.6
Hyatt Hotels Corp.	5.2
FactSet Research Systems, Inc.	5.0
Vail Resorts, Inc.	4.3
Gartner, Inc.	4.1
Total	82.9

Individual weights may not sum to the total due to rounding.

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

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