



Alex Umansky: Staying proactive and focused in the midst of volatility

This is an edited version of a May 27, 2021 Q&A with Alex Umansky, Portfolio Manager of Baron Global Advantage Fund and Strategy, Baron Fifth Avenue Growth Fund, Baron Large Cap Growth Strategy, and Baron Durable Advantage Fund and Strategy. To access the full recording, please dial 800-633-8284, passcode #21993855.

Key Discussion Points

- First quarter growth-to-value rotation
- Interest rates and inflation prospects
- Investing in China
- Private investments
- Outlook for the markets and strategies

Q&A with Alex Umansky

The first quarter of 2021 was marked by a significant rotation from growth to value. After strong outperformance in 2020, all three of your Funds gave back some gains at the start of the year. Could you comment on the drivers of this reversal?

After four or five years of a favorable investing environment and strong returns for our strategies, the environment changed abruptly in the first quarter. While most observers, including us, expected the “reopening trade” to happen at some point in 2021, no one knew exactly when. It happened in the first quarter. We knew that when travel-related stocks, “value” equities that tend to benefit at the outset of an economic recovery, and cyclical sectors like Energy and Financials started to lead the market, we would lag because we are not invested in those stocks or sectors. Conversely, after surging in 2020, the leaders of the digital transformation paradigm that we are levered to did relatively poorly. In addition, our overweight in China, while a positive in the past, hurt performance of Baron Global Advantage Fund.

Do you think we are headed for an inflationary, rising interest rate environment, and, if so, how would you expect your strategies to perform?

Rising interest rates can be a headwind to fast-growing companies and their stock prices, as these companies tend to overinvest in future growth and underearn in the present. Rates impact the cost of capital assumptions and the discount rate we use to bring future expected free cash flows back to present value. So higher interest rates generally mean lower multiples get assigned to fast-growing businesses.

The economic reopening coupled with massive stimulus appear to set the stage for inflation. Most observers are saying we should expect some inflation near term, but it will be transitory. The bond vigilantes are saying rates have got to go higher, which they have and will likely continue to move more. On the other hand, the economy has been growing since the end of the financial crisis in 2009 and rates have gone nowhere. The Federal Reserve

has said repeatedly that it does not expect to raise interest rates until 2023. I'm not suggesting rates will stay at these levels forever, but I am suggesting they will likely remain attractive for an extended period of time.

However, even in a rising rate environment – with rates in the mid- to high-single digit -- we were still able to find unique, competitively advantaged businesses and attractive investment returns. As our shareholders know, macro considerations do not play a meaningful part in our investment process, and we do not plan to change our process or approach based on inflation or interest rate expectations.

Could you offer your views on the investment environment in China at this time?

China has become a real conundrum for us. When the government scuttled the IPO of Ant Financial in November 2020, we initially thought it was an isolated incident in response to former chairman Jack Ma's criticism of regulatory authorities. China's introduction of regulatory tightening and an anti-monopoly review of the country's tech giants shortly after seemed similar to what government authorities were doing in the U.S., and we thought it would largely be rhetoric. However, it now appears that other incentives may be at play. Perhaps President Xi is seeking to emulate the strongman in Russia and ensure that rich and powerful businessmen do not create real opposition. When the rhetoric shifted, it began to feel more dangerous and not as benign as we have thought.

It will take some time to play out, and we have far less exposure to China than in the past. But China is different than when we decided Russia was no longer investible in 2014 because it was essentially run by crime syndicates and there was not enough reward to justify the risk of taking permanent loss of capital. Russia isn't important to the global economy, while China is the world's second largest economy. We've also made significant excess returns in China. For these reasons, our China strategy is more complicated, and we need to ensure we understand where things are headed. We've been talking to consultants, company executives, and political experts in mainland China, Hong Kong and London. In the meantime, we're proceeding with caution.

What are your views on TAL Education Group given China's apparent crackdown on for-profit education services?

Through the end of last year, TAL, which provides private K-12 tutoring services in China, was the most successful investment in the global strategy. We allowed TAL to become meaningfully diluted from a peak of 6% to 7% of assets to 1.4% as of March 31, 2021. As such, we do not believe the recent declines in the stock will have a meaningful impact on performance. We also think TAL is the strongest company in the space. Typically, when the environment gets more challenging, the weaker players -- the underfunded, less capitalized, more aggressive companies that bend the rules -- tend to suffer the most. TAL could actually end up taking advantage of the new regulations to win more market share and become larger and potentially more profitable.

What is happening today is speculation. The rules have not been written, much less published. It remains to be seen whether recent declines will prove to be permanent loss of capital or are driven by short-term fear and uncertainty. Once the rules get published, we'll see what happens.

Are you finding investment opportunities in the current environment?

We are always looking to replace good ideas with better ones and better ones with great ones and market volatility does present us with these opportunities from time to time. That said, we are not yet seeing many meaningful opportunities at this time as the rotation came on the heels of an extraordinary year for growth stocks. While many growth stocks are down 20% to 25% from their highs, that doesn't necessarily make them compelling. In general, we do think that corrections, rotations, and pullbacks are healthy and necessary as well as unavoidable. That's not to suggest we're happy or that we enjoy periods of underperformance. It just means we're not really concerned. We have no idea how long this rotation will go on, but we do believe it is temporary.

You recently added some private investments. How do you become comfortable investing in privates?

Investing in private companies is significantly more complicated because these are very early-stage companies

with no coverage, no track record, and unproven business models that are changing and evolving.

That said, we benefit from the halo effect. Baron Funds was built on excellence in investing in small- and mid-cap stocks, and we are a preferred partner for many pre-IPO companies who reach out to us directly with the hope that we will join them on their journey. We get invited to learn about their business and meet entrepreneurs coming up with real solutions to real problems. This access is part of our competitive advantage.

Private companies will always comprise a small percent of assets because we are not looking to make money off the bat. We will take a small position in a private company exclusively for the purposes of learning the business and gaining the opportunity to be given a meaningful allocation when it goes public.

Are there particular sectors that you find the most fruitful in looking for the “big ideas” you focus on?

The companies we think of as big ideas or the platform businesses with network effects and long tails of unusually durable growth are typically classified in sub-industries within Information Technology or Health Care or are internet or mobile-related. We do not find many big ideas within commodities, energy, industrials, legacy financial, hotels and casinos, and homebuilders; in other words, sectors that have led the market higher in 2021.

But I would caution that it is a misperception to think of our holdings as representing an allocation or an exposure to one theme or trend. How GICs happens to classify a stock is not important to us. It may look as if we are taking the same bet on certain holdings because of short-term correlations but we are not. There are so many different end markets within IT and even within just software. They all have their own demand trends and fundamental drivers of growth. For example, **Snowflake Inc.**, **Wix.com Ltd.**, and **CrowdStrike, Inc.** are all within the same category, so the short-term correlations that you frequently see among these names are mostly a function of their being high-multiple stocks or having similar momentum characteristics. However, their long-term success is not interdependent. Whether they prove to be big ideas five years from now does not depend on how the software sector itself will perform or evolve. Their paths will be their own.

Baron Global Advantage Fund has a five-year upside capture of 136% and downside capture of 55% as of March 31, 2021, which are exceptionally strong figures. Do you expect this level of outperformance to continue?

I think these numbers are kind of silly and obviously not sustainable. I think our 31% annualized net return over the last five years is also not sustainable. We simply do not take enough risks to expect or justify these kinds of returns. We have had an incredible five-year run during which we benefited from strong tailwinds to our style of investing. The more interesting question is whether we can produce or maintain an attractive upside capture of 110% to 120% with a downside capture of 90% or 95%. I think we could if we execute our process well and stay vigilant about creating or maintaining an environment conducive to good long-term decision making.

I recently read some commentary from Garry Kasparov, arguably the greatest chess grandmaster of all time, on what he thinks accounted for his success and what separated contenders from pretenders.

In chess, there are basically three stages: an opening, an end game, and the mid stage. Every chess player memorizes their openings. Your first eight or ten moves are always scripted. If you decide you're playing Queen's Gambit, your moves are predetermined. While the actual moves will vary depending on whether the pawn sacrifice is accepted or rejected or how your opponent chooses to defend against the gambit, you're not reacting to the moves. Your moves are predetermined based on how your opponent chooses to defend. Every variation has been worked out and optimized, and you know exactly how your opening needs to be played in order to enter the mid stage in the most optimal position.

Similarly, once the heavy pieces have been exchanged and the attacks have succeeded or failed, the end game becomes a matter of simple theory execution. Typically, the end game isn't even played out. Once the mid-stage is over, the players get up and shake hands, and the casual observer won't even know who won.

Kasparov observed that it's the mid-stage that more often than not will decide the outcome of the game and that

in every mid-stage there is a nothing-to-do phase. You completed your opening, you accomplished what you wanted. and now there are no obvious moves -- the nothing-to-do stage. Great players know this is when when action is required, while average players are relegated to reacting. The moves tend to be very subtle. It's not clear what they're meant to accomplish. These are the moves that separate the great players from the average ones.

How does this apply to investing? First, we need to realize that almost everything we do is mid-game. We have already played our opening. We have done the due diligence. We have structured our portfolios. We have made our decisions that were optimized to accomplish our goals of long-term appreciation. Second, we need to realize that there is no end game. This is not a sprint or a marathon. We're not optimizing for a score at the end of this quarter or at the end of any given year. Therefore, all we're left with is the mid-game, which by definition mean many periods of nothing-to-do time. We're going through many phases where there will be no obvious moves. I think it is learning how to add value, how to be proactive instead of reactive during this perpetual mid-game, that enabled us to generate our exceptional up/down capture.

I think many fund managers are caught in the perpetual opening stage. They're never set. They're processing an avalanche of data flow, constantly changing information, new ideas and concepts. So they're constantly churning and trying to optimize their portfolios for any given day or market condition. If you're constantly playing your opening, I think it is difficult to generate consistently good up/down capture. Similarly, I think many managers perpetually caught in the end game. When it came out that Archegos Capital, an Asian hedge fund with a lot of Chinese companies, many of which we owned, was liquidating, these stocks fell sharply as managers reacted. When Cathie Wood's ETF was hit with redemptions, managers sold out of stocks she favors. If your end game means optimizing for quarter end, you make the moves.

In our case, we have made our opening and we have no end game. What do we care about the 200 day moving average when it's not designed to tell us anything about what the stock will do three or five years from now. We focus on the mid-game. And we've spent years trying to perfect the skill of subtle, proactive changes.

For example, in the second half of 2020 we had pockets of the portfolio where valuations were in the nosebleed section. At the same time, we had significant inflows which meant these weightings were shrinking. Two of our largest buys were Alphabet Inc. and Facebook Inc. For the first time, Alphabet became the largest position in Baron Global Advantage Fund and Baron Durable Advantage Fund. These positions have since added several hundred basis points of alpha. For the Durable Advantage strategy, we have been able to keep up with the benchmark without exposure to energy, legacy financial stocks, homebuilders, or most of the other industries and stocks that were favored in the first quarter. Although the Global Advantage strategy still got hit because of China, we had already diluted our exposure there. But you look at our portfolios on a quarter-to-quarter basis, you won't see dramatic changes. Our moves were subtle.

As another example, we typically add a handful of names to Durable Advantage each year, perhaps eight to ten to Fifth Avenue, and 15 to 20 to Global Advantage. Half will end up as real positions and real contributors and the other half may not be noticeable. But it happens incrementally, mid-game, and most importantly, proactively.

The trick to long-term outperformance, in my view, is to train yourself to be proactive and moving ahead of time. The majority of investors are reactive. The market goes down, interest rates are up, stocks are down, they react. This is not an effective strategy, in my view. Whatever they are reacting to already happened, and the markets are always forward-looking, so, most likely, this information is already reflected in the stock price.

It's important that our shareholders are aligned with our goals and time horizon of three to five years. We do not manage to short-term macro events or market volatility. We do not pay attention to technical analysis. We do not look for exposure to any themes or subsectors or markets. We are long-term, fundamental, bottom-up, big-idea-driven investors. As a result, our performance and returns may be lumpy. But if you look at rolling returns, the longer the period, the stronger, more compelling, and more attractive they are. For instance, Global Advantage has meaningfully outperformed its benchmarks and its peers 100% of the time on a rolling 5-year basis.

Investors should consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The prospectus and summary prospectuses contain this and other information about the Funds. You may obtain them from the Funds' distributor, Baron Capital, Inc., by calling 1-800-99BARON or visiting www.BaronFunds.com. Please read them carefully before investing.

Baron Global Advantage Fund's annualized returns for the Institutional Shares as of March 31, 2021: 1-year, 90.71%; 5-years, 30.97%; Since Inception (4/30/2012), 20.19%. Annual expense ratio for the Institutional Shares as of December 31, 2020 was 0.92%, but the net annual expense ratio was 0.90% (net of the Adviser's fee waivers). The **MSCI ACWI Index's** annualized returns as of March 31, 2021: 1-year, 54.60%; 5-years, 13.21%; Since Fund Inception (4/30/2012), 10.55%.

Baron Fifth Avenue Growth Fund's annualized returns for the Institutional Shares as of March 31, 2021: 1-year, 63.99%; 5-years, 24.09%; 10-years, 17.52%. Annual expense ratio for the Institutional Shares as of September 30, 2020 was 0.78%, but the net annual expense ratio was 0.75% (net of the Adviser's fee waivers). The **Russell 1000 Growth Index's** annualized returns as of March 31, 2021: 1-year, 62.74%; 5-years, 21.05%; 10-years, 16.63%.

Baron Durable Advantage Fund's annualized returns for the Institutional Shares as of March 31, 2021: 1-year, 47.45%; 3-years, 16.98%; Since Inception (12/29/2017), 16.04%. Annual expense ratio for the Institutional Shares as of September 30, 2020 was 2.40%, but the net annual expense ratio was 0.70% (net of the Adviser's fee waivers). The **S&P 500 Index's** annualized returns as of March 31, 2021: 1-year, 56.35%; 3-years, 16.78%; Since Fund Inception (12/29/2017), 15.12%.

The performance data quoted represents past performance. Past performance is no guarantee of future results. The investment return and principal value of an investment will fluctuate; an investor's shares, when redeemed, may be worth more or less than their original cost. The Adviser reimburses certain Baron Fund expenses pursuant to a contract expiring on August 29, 2031, unless renewed for another 11-year term and the Fund's transfer agency expenses may be reduced by expense offsets from an unaffiliated transfer agent, without which performance would have been lower. Current performance may be lower or higher than the performance data quoted. For performance information current to the most recent month end, visit www.BaronFunds.com or call 1-800-99BARON.

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.

Baron Global Advantage Fund's 1Q 2021, 3- and 5-year historical performance was impacted by gains from IPOs and/or secondary offerings, and there is no guarantee that these results can be repeated or that the Funds' level of participation in IPOs and secondary offerings will be the same in the future.

Risks: The Funds invest primarily in equity securities, which are subject to price fluctuations in the stock market. Growth stocks can react differently to issuer, political, market and economic developments than the market as a whole. Non-U.S. investments may involve additional risks to those inherent in U.S. investments, including exchange-rate fluctuations, political or economic instability, the imposition of exchange controls, expropriation, limited disclosure and illiquid markets, resulting in greater share price volatility. Securities of small and medium-sized companies may be thinly traded and more difficult to sell.

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.

Portfolio holdings as a percentage of net assets as of March 31, 2021 for securities mentioned are as follows:

Snowflake Inc. - Baron Global Advantage Fund (1.4%), Baron Fifth Avenue Growth Fund (2.7%); **Wix.com Ltd.** - Baron Global Advantage Fund (2.6%), Baron Fifth Avenue Growth Fund (1.5%); **CrowdStrike, Inc.** - Baron Global Advantage Fund (1.7%), Baron Fifth Avenue Growth Fund (2.2%).

Top 10 holdings as of March 31, 2021**Baron Global Advantage Fund**

Holding	% Assets
Alphabet Inc.	5.7
Amazon.com, Inc.	4.6
Alibaba Group Holding Limited	4.6
Facebook, Inc.	4.0
Accelaron Pharma Inc.	3.1
Fiverr International Ltd.	2.8
GDS Holdings Limited	2.7
EPAM Systems, Inc.	2.7
RingCentral, Inc.	2.7
Wix.com Ltd.	2.6
Total	35.5

Baron Fifth Avenue Growth Fund

Holding	% Assets
Amazon.com, Inc.	8.1
Alphabet Inc.	6.1
Facebook, Inc.	4.5
Twilio Inc.	3.8
Mastercard Incorporated	3.8
Veeva Systems Inc.	3.6
ServiceNow, Inc.	3.6
EPAM Systems, Inc.	3.4
Adobe Inc.	3.4
ASML Holding N.V.	3.3
Total	43.6

Baron Durable Advantage Fund

Holding	% Assets
Alphabet Inc.	8.6
Microsoft Corporation	8.4
Facebook, Inc.	6.8
Visa, Inc.	4.4
Mastercard Incorporated	4.2
Adobe Inc.	4.1
Moody's Corporation	4.0
Danaher Corporation	3.7
Thermo Fisher Scientific Inc.	3.6
S&P Global Inc.	3.3
Total	51.1

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

The **MSCI ACWI Growth Index** and the **MSCI ACWI Index** cited are unmanaged, free float-adjusted market capitalization weighted indexes. 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. The **MSCI ACWI Index** measures the equity market performance of large and midcap 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. MSCI is a trademark of Russell Investment Group. The **Russell 1000® Growth Index** measures the performance of large-sized U.S. companies that are classified as growth. **S&P 500 Index** measures the performance of 500 widely held large-cap U.S. companies. 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 foreign withholding taxes, which positively impact the performance results. The indexes are unmanaged. The index performance is not fund performance; one cannot invest directly into an index.

Non-mutual fund products are available to institutional investors only.

Alpha measures the difference between a fund's actual returns and its expected performance, given its level of risk as measured by beta. **Beta** measures a fund's sensitivity to market movements. The beta of the market is 1.00 by definition.

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