

BARON CAPITAL INVESTOR

The FinTech Revolution: The Future of Finance

Baron FinTech Fund® | Sector



Josh Saltman
Portfolio Manager

FinTech – financial technology – is revolutionizing the financial industry. The breadth of its impact spans every aspect of financial services – from payments, information and IT services, enterprise software, and capital markets to banks, insurers, and wealth managers. It serves an enormous market – estimated at \$20 trillion worldwide – with financial services companies spending more on technology than any other industry. The growth opportunities of this dynamic landscape are attracting hundreds of emerging companies that compete with or support established financial institutions. Meanwhile, incumbents are developing innovative technology of their own to stay competitive and serve new markets.

The investment appeal of this space is obvious. At the same time, it can present a challenge for would-be investors. FinTech spans several industry categories and is inconsistently defined. There are just a handful of dedicated FinTech mutual funds and no standard benchmark. Most diversified funds have limited exposure to FinTech, while strategies focused on the Financials sector mostly own low-growth banks and insurers. As a highly dynamic industry, the FinTech investment universe can be treacherous to navigate, as evidenced by significant share price volatility for many FinTech stocks. In such an underserved and poorly understood space, we think a skilled active manager has the potential to generate outsized returns.

Baron FinTech Fund

Baron FinTech Fund is an equity mutual fund that invests exclusively in FinTech. The Fund has been managed since inception by Josh

Saltman, who has 18 years of research experience in both Financials and IT services. Josh is supported by Baron Capital’s seasoned research analysts who cover the names and sub-industries for which he does not have primary coverage.

The Fund invests globally across all market caps. We take a high-conviction approach, typically with 40 to 50 positions in the portfolio. The Fund has a high active share of 86% and low three-year turnover of 23.92%.

As set forth in the table below, this approach has produced solid results. The Fund has annualized alpha of 9.09% with beta of 0.88 and up/down capture of 109.72% and 80.90%, respectively, for the three-year period ended March 31, 2024.

Baron FinTech Fund Performance as of 3/31/2024 (annualized)*

	1-year	3-year	Since Inception**
Baron FinTech Fund	29.12%	1.80%	10.58%
FactSet Global FinTech Index	18.05%	-7.39%	2.27%
S&P 500 Index	29.88%	11.49%	13.95%

* Institutional Shares. For Retail and R6 Shares, visit baronfunds.com.

** Inception date: 12/31/2019

Performance listed in the above table is net of annual operating expenses. The gross annual expense ratio for the Institutional Shares as of December 31, 2023 was 1.21%, but the net expense ratio was 0.95% (net of reimbursements from the adviser).

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 waives and/or reimburses certain Fund expenses pursuant to a contract expiring on August 29, 2034, unless renewed for another 11-year term and the Fund’s transfer agency expenses may be reduced by expense offsets from an unaffiliated transfer agent, without which performance would have been lower. Current performance may be lower or higher than the performance data quoted. For performance information current to the most recent month end, visit baronfunds.com or call 1-800-99-BARON

The Fund’s 3-year historical performance was impacted by gains from IPOs and there is no guarantee that these results can be repeated or that the Fund’s level of participation in IPOs will be the same in the future.

Why FinTech

We launched the Fund just over four years ago after many years of successful investing in FinTech companies for existing portfolios across the Firm. In our view, an actively managed FinTech-dedicated Fund is the best vehicle to provide concentrated exposure and enable investors to capitalize on the attractive secular growth trends while steering clear of lower-quality companies. These trends include:

Shift to electronic payments

The world is going cashless, but \$18 trillion of consumer payments each year are still made with cash or check.

Digitization of financial services

Digital providers are challenging incumbent banks that rely on physical branches and manual processes.

Growth of e-commerce

Online sales in the U.S. are growing much faster than in-store sales, but e-commerce penetration is still only 15% of overall retail sales.

Need for digital transformation

Many financial institutions have decades-old technology systems that are difficult to maintain. Disruption from tech-enabled entrants is forcing incumbents to either upgrade their systems or risk losing customers.

These trends are driving the digitization of the financials industry and the growth of FinTech companies. We believe these are inevitable trends that will continue regardless of interest rates, inflation, political unrest, pandemics, and other geo-political and macroeconomic factors.

Differentiated, thematic strategy

We segment the Fund's holdings into seven investment themes.

While we find this construct useful in researching promising companies and managing the portfolio, we do not bet on an entire theme. Rather, we seek to invest in carefully selected, competitively advantaged companies with long runways for growth and exceptional management teams. Some companies have characteristics that span more than one theme, but we classify each company by a single theme that we believe is most representative.

- Information Services
- Payments
- Enterprise Software
- Digital IT Services
- E-Commerce
- Capital Markets
- Tech-Enabled Financials

Information Services

Information services companies provide critical data to help financial institutions improve performance and fulfill regulatory requirements. **S&P Global Inc.** and **Moody's Corporation** provide credit ratings and

MSCI Inc. manages equity indexes that are deeply embedded in the financial ecosystem. **Equifax Inc.** and **TransUnion** provide consumer data and **Fair Isaac Corporation** the rating methodology used by lenders for credit and marketing decisions.

Payments

The pandemic accelerated the digitization of payments as social distancing and fear of contagion forced consumers to shift from cash to digital and contactless payments. We expect many consumers who made fewer cash payments during the pandemic will continue to do so as conditions normalize. With \$18 trillion of consumer purchases and \$120 trillion of business payments still made with cash and checks, we see many years of growth opportunity ahead. **Visa Inc.** and **Mastercard Incorporated** – both top 10 holdings in the Fund – operate leading global networks that facilitate electronic payments for consumers, merchants, and banks.

Enterprise Software

Enterprise software companies help businesses manage their financial processes and operations. Top 10 holding **Intuit Inc.** provides accounting and tax solutions for small businesses and individuals. **Guidewire Software, Inc.** is a leading provider of core systems software for the global insurance industry.

Digital IT Services

Many banks, insurers, and other businesses have decades-old technology that is difficult to maintain. Disruption from new tech-enabled entrants is forcing incumbents to either upgrade their legacy systems or risk losing customers. **Endava plc**, **Accenture plc**, and **Globant S.A.** provide consulting and outsourced software development to help businesses modernize systems and navigate complex digital transformation.

E-Commerce

As with electronic payments, e-commerce sales soared during the pandemic. While the long-term impact of the pandemic boost is unclear, we have no doubt that the secular growth of e-commerce will continue. Online sales have historically grown much faster than in-store sales, but e-commerce penetration is still low at just 15% of U.S. retail sales. **MercadoLibre, Inc.** operates a leading online marketplace and payment service in Latin America, while **Shopify Inc.** provides software and services that make it easier for merchants to sell online.

Capital Markets

Investing decisions and trade execution increasingly rely on digital solutions to improve performance and reduce costs. As a leading electronic trading platform for fixed income markets, **Tradeweb Markets Inc.** benefits from the ongoing shift from voice-based to electronic trading. **CME Group, Inc.** is the world's largest and most diversified derivatives marketplace whose electronic exchanges are used by traders around the world to manage risk.

Top 10 Holdings as of March 31, 2024

Holding	Sector	% of Net Assets
Mastercard Incorporated	Financials	4.9%
Intuit Inc.	Information Technology	4.8%
Visa Inc.	Financials	4.8%
S&P Global Inc.	Financials	4.5%
Fair Isaac Corporation	Information Technology	4.2%
The Progressive Corporation	Financials	4.2%
Apollo Global Management, Inc.	Financials	4.1%
Fiserv, Inc.	Financials	3.4%
MercadoLibre, Inc.	Consumer Discretionary	3.3%
Tradeweb Markets Inc.	Financials	3.1%
Total		41.5%

Tech-Enabled Financials

Forward-thinking financial institutions are using technology in innovative ways to better serve customers and operate more efficiently. **BlackRock Inc.** uses technology to evaluate risk for institutional investors and manage trillions of dollars' worth of ETF assets at very low cost. **Kinsale Capital Group, Inc.** is an insurance company that uses proprietary technology to enable faster underwriting and create meaningful cost advantages. **LPL Financial Holdings Inc.** is a broker-dealer that uses technology to help financial advisors run their practices more efficiently and serve their investors more effectively.

Research-driven, bottom up approach

Within each theme, we apply the Baron Capital investment approach to find companies that we think offer the most promising opportunities for long-term growth. Criteria we look for include:

- Significant growth opportunities
- Sound business model
- Durable competitive advantage
- Exceptional management
- Attractive valuation

Significant growth opportunities

We invest in companies that have significant growth opportunities. Many of our holdings operate in fast-growing markets and are gaining share due to superior products, distribution, or brand recognition. We seek businesses that have large addressable markets with the potential to grow many times in size before reaching maturity.

Sound business model

We seek companies that solve problems and add real value to their customers – a customer-centric approach. Our holdings must have solid balance sheets with appropriate debt levels, strong free cash flow conversion, and recurring or reoccurring revenue. In our experience, a well-run company with a sound business model is more likely to survive in downturns and potentially even benefit as weaker competitors go out of business.

We avoid financial companies that pretend to be technology companies to mislead investors and achieve inappropriately high valuations. Many companies have emerged over the last few years that lend or provide insurance online using new, nifty technology. They may be fine businesses, but they are marketed as technology businesses when they are, in reality, financial businesses using technology and should be valued as such.

Durable competitive advantage

We invest in companies with demonstrable and durable competitive advantages that are difficult or impossible to replicate. While there are plenty of fast-growing, exciting FinTech companies, if they lack a competitive advantage, their growth inevitably slows and, as a result, are not appropriate investments for our long-term approach.

Many of our holdings are leaders in their niche, such as Visa and Mastercard, which together have close to 90% of the global market ex-China (where international companies face significant restrictions). Market leaders typically enjoy entrenched competitive advantages and demonstrated durability.

A unique product also can serve as a competitive advantage. For example, many of our software-as-a-service (SaaS) companies have proprietary software or extensive databases built over many years. Once the product is built, they can sell it many times, so while upfront costs can be meaningful, incremental costs are low and incremental margins are high. We track switching costs, customer reviews, and retention rates for clues into a software company's durability. For instance, Guidewire enjoys high customer retention rates partly due to meaningful switching costs that arise from the operational risks and disruption associated with IT platform migrations.

We continually monitor whether a company's competitive advantage is strengthening or weakening. An example of a company that we believed had a narrowing moat was **Alibaba Group Holding Limited**, the China-based e-commerce and cloud company. After many years of dominance, the incursion of new entrants with better customer value propositions and more well-developed logistical infrastructure began to steadily erode Alibaba's leadership position. While the Fund initially invested in Alibaba, we came to believe that greater competitive intensity would lead to lower growth and margins for Alibaba, so we exited our position in 2022.

Exceptional management

We look for what we believe to be exceptional management teams. Management can make or break a company. The graveyard of failed companies is rife with examples of mismanagement of otherwise promising businesses. In addition, a firm's culture – the shared beliefs, values, and standards – is shaped by management. We look for a track record of successful capital allocation and ability to reinvest for growth.

We speak regularly with the management teams of our companies, so we know the people we are entrusting with our capital. Our

The FinTech Revolution: The Future of Finance

reputation as long-term shareholders gives us a degree of access to management that is unusual in the industry, as management teams are motivated to have us as investors.

Attractive valuation

Finally, we invest only when valuations are sufficiently attractive to meet our return target of a double within five years. We estimate the intrinsic value of every stock we own using quantitative and qualitative analysis. Our valuation models incorporate key revenue growth drivers, profitability, capital structure, and other metrics. Qualitative factors include our proprietary assessments of the total addressable market, durability of the competitive advantage, and strength of the management team. We then seek to invest at a sufficient discount to our estimated intrinsic values to achieve an expected double on our investment within five years.

Balanced, long-term view of risk

We view risk as the potential for a permanent loss of capital. We assess and manage risk from both the bottom up and the top down. At the holding level, we invest only in what we believe to be high-quality companies with solid business models that are selling valuable products or services to meet the real needs of their customers. In a space that is often clouded by hype, we believe a deep understanding of the fundamentals underpinning a company is key in distinguishing the long-term winners from losers.

While the Fund is non-diversified since it invests solely in FinTech, we strive to diversify and balance our holdings across the seven investment themes outlined above. That said, we don't adhere to rigid percentages; rather, the weighting of any specific investment theme results from where we are seeing the best opportunities. As of March 31, 2024, weightings ranged from 24.8% for tech-enabled financials companies to 4.8% for e-commerce companies. This strategy is designed to help manage risk by spreading our "bets" across holdings with different end markets and industry dynamics.

We also manage risk by identifying and maintaining a balance between "Leaders" and "Challengers" in the portfolio. Leaders are generally larger, more established companies with stable growth rates, higher margins, and moderate valuation multiples on near-term earnings and cash flow. Examples include Visa and Mastercard, Intuit, S&P Global, LPL Financial, and Accenture. Challengers are generally smaller, earlier-stage companies with higher growth rates, lower margins (due to growth investments), and higher valuation multiples on near-term earnings. Examples include Endava and MercadoLibre. We expect stocks in both categories to outperform over time, but Leaders tend to have more predictable performance than less-proven Challengers.

Conclusion

We think the long-term outlook for FinTech is bright. While the pandemic accelerated the disruptive trends that are driving growth in the space, these trends were in place well before the pandemic and should continue for years going forward. The demand drivers and earnings prospects for our holdings remain in place despite the post-pandemic slump in valuations. Banks and other financial institutions still have long journeys to digitize their businesses, and innovative FinTech companies continue gaining share. While we are constantly evaluating our holdings to ensure our investment premises are intact, we are also always on the lookout for promising new companies to invest in within this exciting space.

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 1-800-99-BARON or visiting baronfunds.com. Please read them carefully before investing.

Risks: In addition to general market conditions, FinTech companies may be adversely impacted by government regulations, economic conditions and deterioration in credit markets. Companies in the Information Technology sector are subject to rapid changes in technology product cycles; rapid product obsolescence; government regulation; and increased competition, both domestically and internationally, including competition from foreign competitors with lower production costs. The IT services industry can be significantly affected by competitive pressures, such as technological developments, fixed-rate pricing, and the ability to attract and retain skilled employees, and the success of companies in the industry is subject to continued demand for IT services. The Fund is non-diversified, which means it may have a greater percentage of its assets in a single issuer than a diversified fund. The Fund invests in companies of all sizes, including small and medium sized companies whose securities may be thinly traded and more difficult to sell during market downturns.

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, 2024 for securities mentioned are as follows: **Moody's Corporation** – 2.5%; **MSCI Inc.** – 2.8%; **Equifax Inc.** – 1.1%; **TransUnion** – 1.3%; **Guidewire Software, Inc.** – 2.5%; **Endava plc** – 1.2%; **Accenture plc** – 2.3%; **Globant S.A.** – 1.9%; **Shopify Inc.** – 1.5%; **Tradeweb Markets Inc.** – 3.1%; **CME Group, Inc.** – 1.9%; **BlackRock Inc.** – 2.3%; **Kinsale Capital Group, Inc.** – 1.5%; **LPL Financial Holdings Inc.** – 2.9%.

As of 3/31/2024, the Fund did not hold shares of Alibaba Group Holding Limited.

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

The Global Industry Classification Standard ("GICS") was developed by and is the exclusive property and a service mark of MSCI Inc. ("MSCI") and S&P Global Market Intelligence ("S&P") and is licensed for use by BAMCO, Inc. and Baron Capital Management, Inc. (each an "Adviser" and collectively "Baron Capital" or the "Firm"). Neither MSCI, S&P, nor any other party involved in making or compiling the GICS or any GICS classification makes any express or implied warranties or representations with respect to such standard or classification (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability and fitness for a particular purpose with respect to any of such standard classification. Without limiting any of the foregoing, in no event shall MSCI, S&P, any of their affiliates or any third party involved in making or compiling the GICS or any GICS classifications have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages. All GICS structure changes that have occurred since 2016 have been applied retroactively in historical holdings-based analyses, including performance attribution. The Adviser may have reclassified/classified certain securities in or out of a sub-industry within a sector. Such reclassifications are not supported by S&P or MSCI.

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.

Upside Capture explains how well a fund performs in time periods where the benchmark's returns are greater than zero.

Downside Capture measures how well a fund performs in time periods where the benchmark's returns are less than zero.

Active Share a term used to describe the share of a portfolio's holdings that differ from that portfolio's benchmark index. It is calculated by comparing the weight of each holding in the Fund to that holding's weight in the benchmark. Positions with either a positive or negative weighting versus the benchmark have Active Share. **An Active Share** of 100% implies zero overlap with the benchmark. Active Share was introduced in 2006 in a study by Yale academics, M. Cremers and A. Petajisto, as a measure of active portfolio management.

BAMCO, Inc. is an investment adviser registered with the U.S. Securities and Exchange Commission (SEC). Baron Capital, Inc. is a broker-dealer registered with the SEC and member of the Financial Industry Regulatory Authority, Inc. (FINRA).