# Mike Lippert: Secular growth trends have not changed

This is an edited transcript of a July 19, 2022, Q&A with Mike Lippert, portfolio manager of Baron Opportunity Fund and Baron High Growth Strategy and Head of Technology Research. He has over 20 years of investment and research experience.

To access the full recording, please visit [our website](#).

## Executive Summary

- We are confident in the secular growth trends we're invested in. Despite the overarching cyclical aspect of the current market, those secular growth trends have not changed. In an environment like this, the strong tend to get stronger, and that's where we try to invest.
- Sometimes the market overcorrects. When we look across our portfolio, we see potential for solid long-term returns going forward.
- We think long-term. We have managed through market environments like this many times. While they are nerve-wracking and painful, they always end.

***Let's start with a recap of the second quarter.***

The market has been in a dance between inflation and recession, reacting to news on what the Fed may do, unemployment, geopolitics, the Ukraine war. It is not focused on fundamentals or long-term secular growth. I believe this environment presents an attractive buying opportunity. We are confident in the secular growth trends we're invested in. Despite the overarching cyclical aspect of this environment, those secular growth trends have not changed. In a market like this, the strong tend to get stronger, and that's where we try to invest.

***Are you adding names to the portfolio?***

We've concentrated our portfolio, which is now at less than 50 names. We sold some weaker members of the herd to buy the strongest. When stock prices pull back, we look to optimize the portfolio.

When I say "the strong tend to get stronger," I'm not only talking about **Amazon.com, Inc.**, **Microsoft Corporation** or **Alphabet Inc.** (Google). I'm talking about mid-size growth companies hitting their stride. Many of them were trading at very high valuations because they benefited from secular trends that accelerated during the pandemic. We took advantage of the sell off to buy software names like **Snowflake Inc.**, **Cloudflare, Inc.**, **ServiceNow, Inc.**, **CrowdStrike, Inc.**, **MongoDB, Inc.** — strong companies that dominate their niche or vertical.

***Can you discuss your process, what you look for in a company?***

We look for businesses with large, durable secular growth opportunities. The two most critical things are durable competitive advantage and the management team. We do not just talk to the CEO and CFO. We go deeper in the bench. We talk to competitors, partners, customers, industry experts, and others to build a mosaic around the company. Where does the company fit? What is happening in the competitive environment? We ask the same questions in different environments to see how they answer.

On the quantitative side, we build proprietary models using revenue, unit-level economics to project gross margins, operating margins, free cash flow, and other data to estimate key metrics such as earnings, EBITDA, and free cash flow. We favor free cash flow. As for pricing, we establish what we think are appropriate long-term median or average multiples for a particular industry and adjust this number based on the unique elements of the company, including its growth opportunity, management team, growth rate margins, etc.

***Have you done any tax loss harvesting?***

In a selloff like this one where stocks have corrected sharply, we seek to be neutral on overall portfolio performance. We've now locked in $120 million of net tax loss carry forwards. With assets under management between $900 and $950 million, that's a substantial amount of net tax loss carry forwards that we believe will benefit our shareholders in periods when we're in a better market environment.

***Why would you recommend this Fund over a large-cap growth index fund?***

A passive index fund invests in everything in the index without regard to whether the individual holdings are truly growth companies. As active managers, we do not have to invest in everything; we invest where the growth is. Over the last 10 years, with the exception of the pandemic and the current market environment, we've had real growth of roughly 2% and inflation of roughly 2%, which translates to 4% to 5% nominal growth. We seek to invest in companies that are growing 15% or more.

***Can you talk about sourcing new ideas?***

Finding new ideas is not hard. Our target list has more companies than we can invest in. We know the major trends across multiple industries, and we try to identify dominant companies within those trends. We try to improve the portfolio pragmatically and incrementally. We are not making major moves because we don't know where the bottom is. When a company we like is in our buy zone, we will initiate or add to a position.

***What are your thoughts on [cloud-based software-as-a-service provider] ServiceNow, Inc.?***

Our long-term view has not changed. A recession will impact every business, including software businesses like ServiceNow, and software stocks overall have been hit hard year-to-date. But we believe companies benefiting from strong secular growth trends, like ServiceNow, whose products or services are critical for end users, will be impacted less. We've been prudent in our assumptions about what will happen with companies like ServiceNow. We've run different scenarios and believe even our downside scenario is attractive. We think the company's existing business and growth will be highly durable.

***What are your thoughts on Amazon and Alphabet? Both companies recently announced stock splits.***

Oftentimes companies benefit from splits as they attract more retail investors, but the splits do not impact our view. We think Amazon's cloud business -- Amazon Web Services – has more value than its more familiar ecommerce business. We think the cloud business will remain robust even in a downturn. Although its consumer business will likely be impacted in a recession, we expect people will still buy every day from Amazon, although just not as much.

Alphabet is really three businesses. The biggest is Google search. If we fall into a deep recession, it will be impacted but it will be far more resilient than other forms of advertising. The second is YouTube. Trends remain strong even coming out of COVID. It's facing tough compares against the pandemic-driven numbers but is still an attractive business. The third is its cloud business, where it is #3 behind Amazon and Microsoft Azure. We take all three businesses into account in our assessment of intrinsic value, and it is a major position in the portfolio.

***Can you comment on Guidewire Software, Inc., HubSpot, Inc. and ZoomInfo Technologies, Inc.?***

**Guidewire Software, Inc.** is the leading software vendor to the property & casualty insurance industry. Guidewire has transitioned its business to the cloud, and about 90% is now cloud-based. We think its end market will be relatively more resilient in a recession. Guidewire was hurt during the early stages of the pandemic because its projects are large, and clients back-burnered them given the uncertainty. But there's been no impact to the overarching trend. Guidewire has been gaining share on the #2 player as well.

**ZoomInfo Technologies Inc**. uses data to help clients in business-to-business (B2B) advertising, another favorable long-term trend. We call this a 40/40 business because it has 40% revenue growth and 40% free cash flow margin. I believe the B2B go-to-market will be more resilient in a recession than the consumer market.

**HubSpot, Inc.** is like a mini-Salesforce. Its focus is cloud marketing, sales, data analysis, and operations, which is its latest hub. The company focuses on small and mid-size businesses, 20 to 2,000 employees, which is the lower end of Salesforce's client base. Longer term, I believe HubSpot will target businesses with 3,000 to 5,000 employees. HubSpot has been growing at a fast pace. Right now, investors are concerned about what will happen to smaller businesses which tend to be less resilient than larger businesses in a recession. HubSpot also has some European exposure, so that's had a short-term impact.

We believe the secular growth trends for each company are powerful and undeniable. Each may be impacted, but we believe they can be prime examples of the strong getting stronger in this environment.

***What are your views on Datadog, Inc., CoStar Group, Inc., and ASML Holding N.V.?***

**Datadog, Inc.** is a data analytics company that monitors cloud-based apps, so as more apps migrate to the cloud, the more its services are needed. It's been growing at a very high rate and is already generating substantial free cash flow. its unit level economics, such as the cost to add a new dollar of recurring revenue or recurring gross profit, show it to be a standout company. Its founder truly believes in innovation, and it's been very innovative in rolling out new products.

**CoStar Group, Inc.,** which provides analytics and marketing services to the commercial real estate industry, has been a very long-term investment for us. It was the first company assigned to me as an analyst when I joined Baron Capital. I've known CEO Andy Florance for 21 years. He's done an unbelievable job of iterating and innovating over that time. The secular growth has been impressive. This year, CoStar announced plans to expand into residential real estate, which the market greeted with some uncertainty. A recession will have a likely negative impact, but we believe CoStar will be relatively resilient. The company has a great balance sheet, and when other, weaker competitors are struggling, it will try to take market share.

**ASML Holding N.V.** is a near-monopoly company in the semiconductor space. It can't sell enough of its products. Investors are focused on the cyclical nature of the semiconductor industry, and it has been quite volatile of late. However, the industry benefits from the powerful secular trend of digitization, which requires semiconductors. We have been building our position when the stock is in our buy zone.

***What are your thoughts on growth versus value?***

To outperform over the long term, value stocks require economic growth; they don't have the benefit of secular growth trends. When we think about secular growth characteristics, we think of a company that can continue to grow even during a recession. We're comfortable with the secular growth trends we're investing in. We're comfortable with the valuations and the management teams of our companies. I don't know what will happen over the next three or six months. We don't try to predict the market. But over the long term, we see attractive investment opportunities in the areas we emphasize.

***What's the hardest thing about managing the portfolio in this kind of environment?***

In all candor, I'm a competitive person. I always want to outperform. I want to do it for myself and for our investors and business partners. People are entrusting me with their money. I've done this long enough to accept that there are times when you face massive headwinds. There are times when you have tailwinds. Sometimes you have no winds. I try to do the best I can in all of these environments.

I believe in myself and the team I work with. I believe we're doing a good job of not focusing too much on the short term. We stay on top of it and make sure we understand what's going on. But we cannot control macro conditions or broad market movements, so we always take it back to what we can control and try to take advantage of current conditions to optimize the portfolio.

***Any last comments?***

We think long-term. We have managed through market environments like this many times. While they are nerve-wracking and painful, they always end. While no one can predict what will happen in the next three or six months or the next year, we are optimistic about the next five to 10 years.

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*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 Opportunity Fund**'s annualized returns for the Institutional Shares as of June 30, 2022: 1-year, -38.00%; 5-years, 16.88%; 10-years, 14.44%; Since Inception (2/29/2000), 8.15%. Annual expense ratio for the Institutional Shares as of September 30, 2021, was 1.05%. The **Russell 3000 Growth Index**'s annualized returns as of June 30, 2022: 1-year, -19.78%; 5-year, 13.63%; 10-years, 14.41%; Since Fund Inception (2/29/2000), 5.63%. The **S&P 500 Index**'s annualized returns as of June 30, 2022: 1-year, -10.62%; 5-year, 11.31%; 10-years, 12.96%; Since Fund Inception (2/29/2000), 6.69%.

*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, 2032, 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.

The 3-, 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 Fund's level of participation in IPOs will be the same in the future.

**Risks:** Securities issued by small and medium sized companies may be thinly traded and may be more difficult to sell during market downturns. Companies propelled by innovation, including technology advances and new business models, may present the risk of rapid change and product obsolescence, and their success may be difficult to predict for the long term. Even though the Fund is diversified, it may establish significant positions where the Adviser has the greatest conviction. This could increase volatility of the Fund's returns.

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 June 30, 2022, for securities mentioned are as follows: **Amazon.com, Inc.** – 5.8%; **Microsoft Corporation** – 14.00%; **Alphabet Inc.** – 8.7%; **Snowflake, Inc.** – 1.7%; **Cloudflare, Inc.** – 0.5%; **ServiceNow, Inc.** – 2.8%; **CrowdStrike Holdings, Inc. Inc.** – 2.0%; **ZoomInfo Technologies Inc.** – 2.4%; **The Trade Desk** – 1.0%; **Datadog, Inc.** – 0.8%; **Guidewire Software** – 1.5%; **Hubspot, Inc.** – 1.0%;

**CoStar Group, Inc.** – 2.4%; **MongoDB Inc.,** – 1.3%; **ASML Holdings N.V.** – 0.9%

**Top 10 holdings as of June 30, 2022**

| Holding | % Assets |
|---|---|
| Microsoft Corporation | 14.0 |
| Alphabet Inc. | 8.7 |
| Amazon.com, Inc. | 5.8 |
| argenx SE | 4.2 |
| Tesla, Inc. | 4.1 |
| Gartner, Inc. | 3.7 |
| NVIDIA Corporation | 3.3 |
| VISA, Inc. | 3.2 |
| ServiceNow, Inc. | 2.8 |
| Mastercard Incorporated | 2.5 |
| Total | 52.3 |

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

The **Russell 2000® Growth Index** measures the performance of small-sized U.S. companies that are classified as growth. The **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 index 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. Investors cannot invest directly in an index.

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