Alex Umansky: Investing in disruptive technology and big ideas

This is an edited version of a February 18, 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. To access the full recording, please dial 800-633-8284, passcode #21990414.

Key Discussion Points

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Overview of Funds' performance

Q&A with Alex Umansky

- Drivers of outperformance in 2020
- New ideas and the Baron culture of learning
- Big ideas and the distribution of returns
- Application of probabilistic investing principles
- SpaceX, Bitcoin
- Emerging markets

Introduction

Alex Umansky manages Baron Global Advantage Fund, Baron Fifth Avenue Growth Fund, and Baron Durable Fund. Alex has 28 years of investment experience. He joined Baron as a portfolio manager in 2011 from Morgan Stanley, where he was portfolio manager of a number of different strategies.

Baron Global Advantage Fund, which is a global growth fund, returned 79.46% in 2020, significantly outperforming its benchmark, the MSCI ACWI Index, which returned 16.25%. The Fund has a 5-star Overall Morningstar Rating™ and Fund ranked in the top 1% in the Morningstar World Large Stock Category in the 3-year, 5-year, and since inception periods and in the top 2% for the 1-year period as of December 31, 2020.

Baron Fifth Avenue Growth Fund, which is a U.S. large cap growth fund, returned 50.81% in 2020, well ahead of the Russell 1000 Growth Index's return of 38.49%. The Fund also has a 5-star Overall Morningstar Rating™ and ranked in the top 11% for its 1-year return, top 10% for its 3-year return, top 8% for its 5-year return, and top 10% since Alex took over management of the Fund on November 1, 2011, as of December 31, 2020.

Alex's newest Fund, Baron Durable Advantage Fund, also outperformed for the year, returning 20.32% versus the S&P 500 Index, which gained 18.40%. The Fund is a U.S. large cap growth fund that emphasizes businesses with excess free cash flow that can be returned to shareholders,

Morningstar calculates its category averages performance and rankings using its Fractional Weighting methodology. Morningstar rankings are based on total returns and do not include sales charges. Total returns do account for management, administrative, and 12b-1 fees and other costs automatically deducted from fund assets.

As of 12/31/2020, the Morningstar World Large Stock Category consisted of 867, 760, 631, and 438 share classes for the 1-, 3-, and 5-year and since inception (4/30/2012) periods. Morningstar ranked Baron Global Advantage Fund Institutional Share Class in the 1st percentile for the 3-year, 5-year, and since inception periods and in the 2nd percentile for the 1-year period.

As of 12/31/2020, Baron Global Advantage Fund Institutional Share Class received 5 stars for its 3-year, 5-year, and overall performance.

As of 12/31/2020, the Morningstar Large Growth Category consisted of 1,289, 1,197, 1,070, and 789 share classes for the 1-, 3-, 5-, and 10-year periods. Morningstar ranked Baron Fifth Avenue Growth Fund Institutional Share Class in the 11th, 10th, 8th, and 11th percentiles, respectively.

As of 12/31/2020, Baron Fifth Avenue Growth Fund Institutional Share Class received 5 stars, 5 stars, 4 stars, and 5 stars for its 3-, 5-, and 10-year and overall performance, respectively.

The Morningstar Ratings™ are for the Institutional share class only; other classes may have different performance characteristics.

Q&A with Alex Umansky

All three of your strategies outperformed in the highly unusual market environment of 2020. Could you talk about what you attribute this outperform to?

2020 can be divided into three distinct segments. It started with continued momentum from 2019 with markets rising until the peak of February 19, followed by a massive selloff until the bottom on March 23. And then the rally and market recovery from there, essentially through the end of the year.

In a way, it is reasonable to look at this period as a full market cycle in terms of magnitude and impact to stocks and performance, albeit a mini-cycle in terms of time. When examined in that framework and compared with our benchmarks, all three strategies outperformed in all three stages. We generated excess returns on the way up. We held up better on the way down. And outperformed again on the way up.

We attribute these results to three factors. First, our focus on disruptive change. We start by trying to understand whether the disruption is real, material, and sustainable. And we evaluate investment decisions and portfolio construction through that disruptive change lens.

Now typically change is slow. It is painful. It is costly. There's often institutional resistance to change, and many actors in our business are slow to change and push it off as far as possible. So it often takes a crisis for the change to get implemented.

The bursting of the dot com bubble, the 9/11 terrorist attacks, and the bursting of the housing bubble in 2008-09 are examples of such crises. The onset is always fast. It is always furious. These liquidity crises are created virtually overnight. And then it is a race against time, and lower quality, highly leveraged companies almost always go down first. After that, valuation suddenly comes into focus and the appetite for high-multiple stocks dries up, and they go on sale. Then you have a risk-off and your correlations basically go to one.

All of these crises had certain things in common. They tended to be broad-based, with every segment of the economy suffering and contracting. Some suffered more like technology startups in the early 2000s or financials and real estate during the housing bubble, and other segments suffered less, but everyone suffered.

What was unusual about the crisis of 2020 is that, while it hit some industries like travel and leisure and energy particularly hard, it also created a relatively large category of winners. There was no work from home segment or ETF before, and now there is. We had identified digital transformation as the single most important disruption years ago, and all our investment decisions were made with this in mind. As it happened, the pandemic proved to be a massive accelerant of digital transformation. The analog world was not equipped to handle information access from any device or location in an efficient, scalable, and secure manner and, as a result, that analog world got shut down. But if you were digitally enabled, not only were you not missing a beat, you were taking share and winning more business than you could handle. The beneficiaries of this disruption were identified fairly quickly. Since we already owned many of them, we held up significantly better than the indexes and most of our peers.

Second, we invest in high quality businesses which, as I mentioned earlier, tend to decline less in the earlier parts of the market selloff, and because the cycle was compressed, we basically never got to a stage where everyone just wanted out.

Third, we avoided any significant mistakes. Now, mistakes are definitionally unavoidable and, while we always work on minimizing the frequency and the impact of mistakes, in times of extreme uncertainty, our focus shifts almost entirely to the risk side of the equation. Our biggest mistakes during this cycle were selling **Tesla, Inc. (TSLA)** and **Zoom Video Communications, Inc. (ZOOM)** way too early. These mistakes did not result in permanent loss of capital but were more of a missed opportunity. Fortunately, a missed opportunity, even a big one, is easier to make up for than one that actually blows a hole in your entire portfolio.

Despite the errors of omission you touched on, your strategies generated strong returns in 2020, and it wasn't just a few stocks that drove performance. In Baron Global Advantage Fund, 27 of 60 holdings more than doubled in 2020. 33 holdings contributed more than 100 basis points, and 11 of those 33 holdings were below $15 billion in market cap. In Baron Fifth Avenue Growth Fund, 15 of 37 holdings appreciated more than 75% in 2020, and 18 of 37 holdings contributed at least 100 basis points. I think this speaks to the breadth and depth of the portfolios despite being concentrated. Would you like to expand on that thought?

We invest in big ideas. This means the company must have the ability to become materially larger, versus a holder of value. We look for certain characteristics like platform businesses with ecosystems, network effects, and parallel distribution. We focus on the tail end of the distribution of returns. To borrow from Jeff Bezos, in baseball, every home run counts the same whether you clear the fence by an inch or a mile. But in our business, that distinction makes a real difference. There is a material difference between a good idea or a good company and a great one. There's another order of magnitude between a great one and a fantastic or a rare one.

Think of a bell curve. We focus on the tail of that distribution. When you get a year where a major disruption results in a massive accelerant, you end up with the kind of results we had.

That's the good side of the tail end of big ideas. It's important to understand that we similarly obsess with tails on the other side. We're not terribly concerned with a company delaying a product launch or missing quarterly estimates where the stock can decline 10% or 15% as a result. But we are very concerned with tail risk and Kelly criterion and what would happen if our thesis were completely wrong. In this environment, which has largely been favorable to the kinds of businesses that we investment in, our concern for tail risk did not play out. We're okay with that because we believe it will serve our shareholders well over the long term.

At the beginning of the crisis, your portfolios become more concentrated. Baron Global Advantage Fund went from 49 to 45 positions in the first quarter of 2019 and Baron Fifth Avenue Growth Fund went from 34 to 29 positions. Now, at the end of 2020, Baron Global Advantage Fund is up to 60 positions and Baron Fifth Avenue Growth Fund is up to 37 positions. Could you explain your thinking there?

When the environment becomes more uncertain and the range of outcomes widens considerably, we will contract or move inwards within our portfolios by selling our lower conviction names. On the other hand, a favorable market environment buys companies time that can allow them to grow from good ideas and good businesses into great ones.

Where are you getting your new ideas?

The Baron culture of learning leads directly to idea generation. We are never short of new ideas. We set out to learn and to understand and new ideas basically just take care of themselves.

Firm culture comes from the top. And Ron sets a really good example for the research staff. There's a real desire to understand how things work. We don't go into meetings with companies for the purpose of drawing investment conclusions. Anyone who's been in a meeting with Ron can attest to how tireless and relentless he is with his questions. "Do this again for me. I understand this part but I'm not getting this other part. Can you please explain one more time?" He just never stops until he gets it, and even then, he tells management, "You know, this was a fantastic meeting, but we must do this again real soon. I apologize in advance, but I'm going to make you explain it to me all over again one more time just to make sure that I really get it." It is the same with all our analysts. They drill the management teams over and over. Drawing conclusions becomes an outcome of the learning process.

You are an adherent of Michael Mauboussin's probabilistic investing principles. Can you talk about what your probabilistic approach means as it relates to valuation and risk and why this is important to investing?

While there is one version of the past or one specific way that events unfolded, we all understand that they could have unfolded differently. Good and bad decisions were made, and they all have consequences that led to certain outcomes. It is the same with the future. The future is inherently uncertain, and it can unfold in many ways. Some of it will depend on the decisions that we or others make and some of it will happen without any risk control. When we build our models or our "nth" game scenarios, we usually underwrite a base case scenario that reflects what we believe the growth rate and profitability would look like if our analysis is correct and things remain as they are. We also examine the bull case or best case scenario and the worst case scenario and try to assign the probabilities and the consequences of these things happening. So when we allocate capital, we always do so against the entire range of outcomes as opposed to what we think is either the best or most likely scenario.

Mauboussin has done a phenomenal job of explaining how this exercise helps avoid false precision and adds robustness and balance to how you think about future outcomes. Most importantly, if done properly, it should lead to better decision making. We try to be faithful practitioners of this way of analysis, and we absolutely believe this probabilistic approach can be a real competitive advantage versus others that focus on single outcomes.

You are not invested in Tesla at this time. Do you have an interest in Elon Musk's other adventure -- SpaceX?

How can you not have an interest in SpaceX? Coincidentally, isn't NASA's Perseverance probe set to land on Mars today? I think it is pretty well known that Baron Capital Group and Ron in particular have been both an earlier investor and big supporter of Elon Musk and SpaceX.

An opportunity to invest in SpaceX had been offered to me in the past which I turned down because the Funds were too small in terms of AUM to invest in a private company. I also thought it was way too early and had no idea how to value SpaceX. Suffice it to say, if present or future opportunities to investment in SpaceX were to be made available, we would be very interested and would give it very serious consideration.

We are now managing about $4.3 billion in the three strategies. Having said that, it is unlikely we will ever take a stake in a private company that could move the dial. The purpose is not to hit homeruns with these early opportunities. The purpose is to acquire a de minimis stake, secure a seat at the table, and sit and learn how and why they work and if not why they don't.

Can you share your view on Bitcoin and cryptocurrencies?

Our investment process requires us to understand or estimate a company's intrinsic value. The various attempts to calculate the intrinsic value of Bitcoin that I have seen are plainly lacking. It's unclear whether Bitcoin or any the cryptocurrencies even have intrinsic value. This is an area that requires attention and careful monitoring and will undergo continuous change and adjustments so none of the crypto assets are appropriate investments in my view for any of our strategies.

I've been talking about blockchain as a disruptive technology. Blockchain is a technology in which currency is completely decentralized. In that sense, it offers an elegant solution to a very obvious and real problem. It started during the financial crisis when we were introduced to ZIRP, or zero interest rate policy. 13 years later, we have multiple currencies being debased by their governments and non-stop money printing. Even worse, our own government chose to weaponize the world's only reserve currency, the U.S. dollar, against China and other countries. Now we have a global economy that is addicted to easy money, and it is hard to see how we break this addiction. There are lots of unanswerable questions with blockchain, but the opportunity to solve a very real problem is self-evident.

What I think is more interesting, and where the value lies in crypto is in the platform and the ecosystem being created. It's **Square, Inc. (SQ), PayPal Holdings, Inc. (PYPL)** and **Mastercard Incorporated (MS).** Elon Musk is saying that Tesla might start accepting Bitcoin as payments for cars, and Dara Khosrowshahi is talking about enabling **Uber Technology, Inc. (UBER)** drivers to accept Bitcoin for rides and deliveries.

I've been telling Ron that we should launch a crypto fund just based on the sheer number of questions I am getting and the amount of client interest and energy around this. I even know a portfolio manager who might be willing to run this crypto fund and who understands distribution of returns and would know how to structure what looks like a very asymmetric opportunity. And I wouldn't worry too much that he already manages three other funds because he doesn't travel anymore, and he works from home all the time. That's what my life is. I think we're creative and unconventional enough, and we just need the courage to think this through and to carry it out.

Your emerging markets exposure in Baron Global Advantage Fund ticked up to 27% at the end of the year. Does this represent a more bullish position?

I've always been bullish on emerging markets. Emerging markets are a less efficient, much cheaper asset class. It will undoubtedly grow faster over the next 10 years than the developed markets and our overweight is unlikely to change. But we're overweight because I think the benchmarks have it wrong. The benchmarks are backward looking and we are forward looking. From this perspective, I think we have a structural advantage, and 27% EM is around where we have averaged since inception. It's true that hurdle rates are higher in EM. You need to be disciplined about risk management. But we believe we have an advantage in terms of our research ability, our time horizon, and our ability to analyze and due diligence these businesses.

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 December 31, 2020: 1-year, 79.46%; 5-years, 30.14%; Since Inception (4/30/2012), 21.09%. Annual expense ratio for the Institutional Shares as of December 31, 2019 was 1.00%, 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 December 31, 2020: 1-year, 16.25%; 5-years, 12.26%; Since Fund Inception (4/30/2012), 10.29%.

Baron Fifth Avenue Growth Fund's annualized returns for the Institutional Shares as of December 31, 2020: 1-year, 50.81%; 5-years, 23.24%; 10-years, 18.10%. 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 December 31, 2020: 1-year, 38.49%; 5-years, 21.00%; 10-years, 17.21%.

Baron Durable Advantage Fund's annualized returns for the Institutional Shares as of December 31, 2020: 1-year, 20.32%; Since Inception (12/29/2017), 16.34%. 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 December 31, 2020: 1-year, 18.40%; Since Fund Inception (12/29/2017), 14.18%.

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 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: 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 **Morningstar Rating™** for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The Morningstar Rating does not include any adjustment for sales loads. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10- year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods.

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 December 31, 2020 for securities mentioned are as follows: PayPal Holdings, Inc. – Baron Fifth Avenue Growth Fund (2.5%); **Mastercard Incorporated** – Baron Fifth Avenue Growth Fund (3.9%), Baron Durable Advantage Fund (3.1%)**.**

Baron Fifth Avenue Growth Fund, Baron Global Advantage Fund, and Baron Durable Advantage Fund did not hold **Tesla, Inc., ZoomVideo Communications, Inc., Square, Inc.,** or **Uber Technology, Inc.** as of December 31, 2020.

Top 10 holdings as of December 31, 2020

Baron Global Advantage Fund

Holding	% Assets
Amazon.com, Inc.	5.0
Alibaba Group Holding Limited	4.7
Alphabet Inc.	3.9

RingCentral, Inc.	3.4
GDS Holdings Limited	3.4
Facebook, Inc.	3.3
MercadoLibre, Inc.	3.1
Acceleron Pharma Inc.	3.0
Fiverr International Ltd.	2.6
Opendoor Technologies Inc.	2.6
Total	35.0

Baron Fifth Avenue Growth Fund

Holding	% Assets
Amazon.com, Inc.	8.5
Alphabet Inc.	4.5
ServiceNow, Inc.	4.0
Mastercard Incorporated	3.9
Twilio Inc.	3.9
Veeva Systems Inc.	3.8
RingCentral, Inc.	3.8
Adobe Inc.	3.7
Facebook, Inc.	3.5
Alibaba Group Holding Limited	3.4
Total	43.0

Baron Durable Advantage Fund

Holding	% Assets
Microsoft Corporation	7.4
Alphabet Inc.	6.4
Adobe Inc.	4.8
Moody's Corporation	4.6
Danaher Corporation	4.5
Thermo Fisher Scientific Inc.	4.5
Facebook, Inc.	4.4
S&P Global Inc.	3.8
Accenture plc	3.7
UnitedHealth Group Incorporated	3.5
Total	47.6

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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