Andrew Peck: Investing in mid-cap growth stocks in a challenging market

This is an edited version of a May 19, 2021 Q&A with Andrew Peck, Baron Capital co-Chief Investment Officer and Portfolio Manager of Baron Asset Fund, Baron Mid Cap Growth Strategy, and Baron All Cap Growth Strategy. To access the full recording, please dial 800-633-8284, passcode #21993838.

Key Discussion Points

- Drivers of performance in the first quarter of 2021
- Purchase and sales activity
- The possible impact of an inflationary environment on the portfolio
- New areas of opportunity
- IDEXX Laboratories, Inc.

Baron Asset Fund

Could you recap Fund performance in the first quarter of 2021?

The first quarter was dominated by the shift from growth to value, driven primarily by a sharp increase in interest rates and investor concerns around inflation prospects, both of which served to diminish the interest in growth stocks broadly throughout the market. Instead, the market focused on companies that will get the most juice from the short-term dynamics arising out of upward revisions in GDP, employment expectations, and consumer spending.

Within the growth space, the best performers were the Energy sector; cyclical stocks in the Industrials and Materials sectors; and the Financial sector, which benefited from the uptick in interest rates. On the downside, the Information Technology (IT) and Consumer Discretionary sectors experienced major corrections, and defensive sectors such as Health Care, Utilities, and Consumer Staples dragged during the quarter.

Baron Asset Fund trailed the Russell Midcap Growth Index by 46 basis points. The index was down 57 basis points while the Fund was down 103 basis points.

Standout holdings included **Tripadvisor, Inc.**, a new purchase during the quarter. Within Health Care, the Fund's underweight in biotechnology and long-time holding **Bio-Techne Corporation** contributed. Financial Sector investments did well, most notably brokerage firm **The Charles Schwab Corp.** and **First Republic Bank**.

Two data and analytics companies within the Industrials sector, **Verisk Analytics, Inc.** and **CoStar Group, Inc.**, led detractors. As more growth-oriented stocks, Verisk and CoStar suffered in the rotation toward more value-oriented, cyclically exposed names. Consumer Discretionary holdings also hurt performance, notably recent purchases **Farfetch Limited** and **Stitch Fix, Inc.** REITs holdings **Equinix, Inc.** and **SBA Communications Corp**. also dragged due to the increase in interest rates. Lastly, P&C software platform **Guidewire Software, Inc.** and payroll software provider **Ceridian HCM Holding Inc.**, both within IT, were material detractors in the quarter.

Any purchases and sales activity in the quarter you'd like to highlight?

Our largest purchase was **Tripadvisor, Inc.,** the leading hotel meta search site. It has a massive user base of close to 500 million unique monthly users on average. While travel is likely to be a beneficiary of the postpandemic reopening of the economy, we bought Tripadvisor because of several company-specific developments.

First, Tripadvisor installed a new management team whom we believe brings key skills and experience the company had lacked until now.

Second, as a result of measures taken during the pandemic, we think the company has permanently lowered its cost structure such that, if and when revenues rebound, it will be structurally more profitable than in the past.

Third, Tripadvisor has devised a variety of ways to better monetize its enormous user base. Most notably, it plans to introduce a subscription service for $99 a year that will allow users to achieve meaningful benefits and discounts on hotels booked through the site. We think this can be a source of meaningful growth.

We also purchased **EPAM Systems, Inc.**, which provides outsourced software development for businesses. EPAM benefits from growing demand for IT services and digital transformation from companies around the world. EPAM's competitive differentiation comes from its ability to hire and retain highly skilled, low-cost software engineers, primarily in Eastern Europe and Russia. The company has less than 2% of a $150 billion market and has been growing at double digits. We think it will continue to grow at that rate as a result of increased emphasis on technology spend and digital transformation.

Our largest sale was veterinary diagnostics company **IDEXX Laboratories, Inc.** It remains our largest holding, but after more than doubling over the last year, the stock had become a particularly outsized position, so we reduced its weighting in the portfolio for risk management reasons.

We also sold **Booking Holdings, Inc.** because of our investment in Tripadvisor, which serves a similar end market, and because Booking had become large cap, and we wanted to maintain our mid-cap focus. We sold **FleetCor Technologies, Inc.,** a long-time successful investment. The company provides fuel purchase cards for trucking companies, and, given our belief that there will be a long-term secular trend away from fuel-based vehicles in favor of electric vehicles, we decided to exit that position. Lastly, we exited food delivery service **DoorDash Inc.** We had made an attractive return, and it reached a valuation that we thought did not offer reasonable upside over the next five years.

How would you expect the Fund to perform in an inflationary environment?

Although the market appears to believe we could be headed into an inflationary environment, we do not invest based on whether interest rates or inflation will be higher or lower going forward, as we do not think it is possible to predict with any degree of accuracy. What I do know is that if you look at the history of stock performance in inflationary environments, the two types of stocks that tend to perform best over the long haul tend to have pricing power and/or high returns on invested capital. As investors in stocks with durable long-term growth opportunities, these are the types of stocks we seek to own, and I'm optimistic that the Fund will perform well in an inflationary environment.

We also think valuations of many of these holdings are much more attractive today on both a near-term and long-term basis. During the first quarter, the Russell Midcap Value Index outperformed the Russell Midcap Growth Index by 1,400 basis points. Over the last 12 months, the value index is outperforming the growth index by 3,100 basis points. As a result of that rotation, many secular growth names in IT, Consumer Discretionary, and other sectors are off 30% to 60% from their highs in February.

In addition, as secular growth companies tend to be less GDP-sensitive than cyclical companies, a number of them posted positive upward revenue earnings and cash flow revisions during the quarter. For example, two IT stocks we own, **RingCentral, Inc.** and **Wix.com, Ltd.,** continued to report exceptional earnings results despite falling dramatically in the past couple of months. Ultimately the companies we own that have suffered the most over the last couple of months are, in many cases, the ones we believe are best positioned to outperform over the next three to five years.

The pandemic certainly had a profound impact on how we conduct our lives, and many observers expect the "new normal" to be different from the "old normal." Are there specific areas where you are finding more opportunities than six months or a year ago?

The portfolio had been underweight IT relative to the index. The rationale was not that I was a skeptic of the disruption throughout the economy that would likely benefit tech stocks over the long term. Rather, it was more that I did not find the valuations of many IT companies -- software in particular – to be attractive. Given the meaningful correction in IT and especially software, we are focusing on opportunities in the space.

What keeps you excited about IDEXX, almost 15 years after you originally invested in it?

IDEXX sell devices to veterinarians to test blood, urine, and other specimens of cats and dogs, primarily when they're brought into a veterinary office or when those samples are sent to a third-party testing lab. It's now a roughly $40 billion company yet growing as fast as ever. IDEXX has become the de facto leader in market and is even further ahead of its competitors than at any point in the past. Recently, IDEXX has benefited from the meaningful increase in the number of cats and dogs owned by people around the world during the pandemic. I think this is a sustainable trend that will not reverse anytime soon because the average life of cats and dogs is 10 or 15 years.

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 Asset Fund's annualized returns for the Institutional Shares as of March 31, 2021: 1-year, 58.28%; 5-years, 20.05%; 10-years, 14.74%; Since Inception (6/12/1987), 12.34%. Annual expense ratio for the Institutional Shares as of September 30, 2020 was 1.05%.

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 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.

Risks: Securities issued by medium sized companies may be thinly traded and may be more difficult to sell during market downturns. 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 March 31, 2021 for securities mentioned are as follows: **Tripadvisor, Inc.** (1.5%); **Bio-Techne Corporation** (2.7%); **The Charles Schwab Corp.** (2.1%); **First Republic Bank** (0.9%); **Verisk Analytics, Inc.** (3.0%); **CoStar Group, Inc.** (3.1%); **Farfetch Limited** (0.9%); **Stitch Fix, Inc.** (0.7%); **Equinix, Inc.** (1.1%); **SBA Communications Corp**. (1.8%); **Guidewire Software, Inc.** (2.5%); **Ceridian HCM Holding Inc.** (2.4%); **EPAM Systems, Inc.** (0.9%); **IDEXX Laboratories, Inc.** (6.4%).

Top 10 holdings as of March 31, 2021

Holding	% Assets
IDEXX Laboratories, Inc.	6.4
Gartner, Inc.	5.0
Mettler-Toledo International, Inc.	3.9

ANSYS, Inc.	3.5
Vail Resorts, Inc.	3.1
CoStar Group, Inc.	3.1
Verisk Analytics, Inc.	3.0
Zillow Group, Inc.	2.9
Bio-Techne Corporation	2.7
Guidewire Software, Inc.	2.5
Total	**36.1**

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

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