COVID-19's Impact on the Health Care Sector

This is an edited version of an October 29, 2020 Q&A with Baron Health Care Fund Portfolio Manager Neal Kaufman and Assistant Portfolio Manager Josh Riegelhaupt. To access the full recording, please dial (800) 633-8284, passcode #21969437.

Key Discussion Points

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Introduction

Baron Health Care Fund is managed by Neal Kaufman, who joined Baron in 2005 and has 19 years of research experience. Assistant Portfolio Manager Josh Riegelhaupt, who has a Ph.D. in Genetics and Molecular Biology from Rockefeller University, joined Baron in 2014 and has 10 years of research experience.

Since Baron Health Care Fund launched on December 29, 2017, the Fund has achieved some impressive numbers. Year-to-date through September 30, the Fund is up 26.16%, outperforming the Russell 3000 Health Care Index by 17.75%. In 2019, the Fund returned 35.57%, outperforming its benchmark by 13.46%. Neal and Josh have managed the Fund since inception.

Baron Health Care Fund

What, in your view, is driving the Fund's strong performance year-to-date?

Neal Kaufman: Overall, our holdings have performed well in an extremely challenging environment. We invest in what we think are best-in-class companies with large addressable markets, positive secular changes, competitive advantages, and great management teams. These attributes really shine in more uncertain environments like the one we are facing now. We have also avoided areas of the sector with growth challenges like generic drugs, drug distributors, drug retailers, and large cap pharmaceuticals.

How are you positioning the portfolio in response to the pandemic and its impact on the health care sector?

Neal Kaufman: We continue to construct the portfolio from a bottom-up fundamental perspective, investing in the themes we believe have the best long-term growth potential in the space.

Several of our holdings are seeing a boost in sales of COVID-19-related products such as diagnostic tests, protective equipment, and packaging components for therapeutics and vaccines, but we don't own them because of that. For example, we own companies that sell diagnostics for COVID-19 like **Abbott Laboratories (ABT)** and **Roche Holding AG (RHHBY)** and others that are developing vaccines like **Sanofi (SNY)** and **AstraZeneca PLC (AZN),** but we're not invested in them because we're making a bet on their success or failure with COVID-19. We're also not making changes based on a possible shift from growth to value or a cyclical rotation, which many strategists are calling for once vaccines are approved and the economy recovers from current depressed level.

Where are you seeing opportunities?

We are seeing opportunities throughout the sector, but I'll touch on three investment themes that are a focus for us: genomics, medical technology, and Medicare Advantage.

Genomics DNA sequencing – the reading and analysis of the three billion chemical "letters" in a human genome – is a transformative technology, with potentially far-reaching impact. As the cost of DNA sequencing has fallen, the applications are rapidly expanding. DNA sequencing is already being used in cancer diagnosis and treatment, diagnosis of rare genetic diseases, noninvasive prenatal testing, and population and consumer genomics.

Baron has been invested in **Illumina, Inc. (ILMN),** the market leader in DNA sequencing technology, for many years. Illumina recently announced the acquisition of Grail, which is developing a blood test for early cancer detection using DNA sequencing. Other genomic companies we own include **Guardant Health, Inc. (GH), Adaptive Biotechnologies Corporation (ADPT), 10X Genomics, Inc. (TXG)**, and **Pacific Biosciences of California, Inc. (PACB)**.

Medical technology We believe the use of software-based data and analytics to speed drug development has massive growth potential. A good example is **Schrodinger, Inc. (SDGR),** which has a computational platform that can predict the binding affinity of a drug molecule with a high degree of accuracy. This platform enables scientists to discover novel molecules more rapidly at lower cost and with a higher likelihood of success. Schrodinger is using its platform to screen for and evaluate protein targets for COVID-19. Another example is **Veeva Systems Inc. (VEEV)**, a provider of cloud-based software that helps clients bring drugs to market faster and more efficiently.

Medicare Advantage Every day approximately 10,000 people in the U.S. become eligible for Medicare. Individuals have a choice between enrolling in traditional fee-for-service Medicare or a Medicare Advantage plan managed by a private sector health insurer.

Medicare Advantage plans are growing rapidly because of their more attractive value proposition, as they cover all the services that traditional Medicare covers plus benefits like vision, hearing, dental, and wellness. Some Medicare Advantage plans also cover transportation for office visits, OTC drugs, adult daycare, and daily living assistance. These plans also have annual out-of-pocket spend limit, which provides financial protection against the cost of catastrophic illness or accidents.

The Center for Medicare and Medicaid Services estimates that Medicare Advantage penetration will rise from 36% of all Medicare beneficiaries in 2020 to 50% in 2025. There is strong bipartisan political support for Medicare Advantage, which insulates the program from political risk.

We have investments in **UnitedHealth Group Incorporated (UNH)** and **Humana Inc. (HUM)**, two leading managed care organizations that we believe are well positioned to benefit from growth in Medicare Advantage. We also expect several smaller privately held fast-growing Medicare Advantage plans to go public soon, which will provide additional opportunities to invest in this theme.

Could you highlight a couple of the new names in the Fund?

Neal Kaufman: PacBio, a genomics company I mentioned earlier, is a new position. We participated in a secondary raise after the company brought in the former Chief Commercial Officer of Illumina as CEO. It's developed a long-read platform that enables longer strands of DNA to be read, which can capture genomic variations that may be missed by short-read sequencers such as Illumina's. The knock on long-read has always been that it's very slow and not very accurate. PacBio thinks it has figured out how to dramatically increase the speed and accuracy of this type of sequencing. Cost has also historically been a barrier to adoption for long-read sequencing, but PacBio has been investing in improving cost per sample. To date, long-read sequencing has been used for niche applications, but we believe if PacBio can successfully improve the accuracy, speed, and cost of its long-read sequencing platform to approach that of short-read sequencing, it will can expand the applications for its platform.

You added significantly to your existing investment in Acceleron Pharma Inc. (XLRN), and it's now a top 10 position. What is your investment premise for the company?

Josh Riegelhaupt: We've held Acceleron for a while but added to our position this past quarter as there was a trading dynamic in play that hurt share performance.

We're excited about Acceleron primarily because of two drugs, one approved and the other in Phase 3 trials. The approved drug, Luspatercept, treats anemia. We first invested in Acceleron after Luspatercept showed superior clinical data and a preferred product profile. Fast forward to today, in a COVID-19 environment, patients are understandably reluctant to visit infusion centers potentially every week to receive blood transfusions. Luspatercept, in contrast, can be given as a simple injection once every three weeks. This advantage has helped accelerate launch, and we expect sales upwards of two billion and a potential peak at three to four billion.

The second drug, Sotatercept, treats pulmonary arterial hypertension ("PAH"), a devastating disease that generally leads to death within five to seven years of diagnosis with an average age of onset of about 50. While there are many approved drugs doing billions in sales for PAH, they all offer only symptom relief. Sotatercept is the first modality that addresses the underlying cause of PAH. With more than 100,000 patients worldwide, we expect Sotatercept will achieve multi-blockbuster status as well.

Sector Outlook

What is your current outlook for the Health Care sector?

Neal Kaufman: Regardless of the election outcome, we think there is bipartisan support for increased funding for life sciences research and the Medicare Advantage program. The regulatory environment is favorable for health care, and the financing environment for innovative biotechnology and medical technology companies is robust. We believe spending on health care will continue to rise. Innovative health care companies continue to use technology to drive better patient outcome at lower cost. We're meeting with a ton of interesting private companies planning to go public soon. For all these reasons, we think this is an excellent time to invest in health care if you have a long-time horizon.

What are your thoughts about the likelihood and the timing of COVID-19 treatments and vaccines?

Josh Riegelhaupt I certainly don't have a definitive answer to that question, but there are several considerations to keep in mind as we monitor progress on these fronts.

First, the more quickly trial data is provided, the more likely the vaccine is effective. This is because vaccine trials are timed events. On day one, patients are randomly assigned to a vaccine group and a placebo group. The patients get their first shot, then a booster shot, and then are simply followed until they get COVID-19. As that number is currently just about half a percent of the population, these trials enroll 30,000 to 40,000 patients. Once enough patients have COVID-19, the trial will have passed a predetermined number of total events, which allows for an interim view of the data. The better the vaccine, the more likely you will see a statistically meaningful difference in the number of COVID-19 cases in either group. On the other hand, the worse the vaccine, the more total events are needed to see a statistical difference. This means you need to enroll and test more patients, which means more time. For this reason, the longer a trial takes to read out, the less likely the vaccine is effective.

Right now, four major pharmaceuticals are testing vaccine candidates. I am cautiously optimistic we will see good efficacy data. According to the projections we are hearing from the pharmaceutical companies, it is reasonable to think that, by late spring into the summer of 2021, a large percentage of the population will be vaccinated. The million-dollar question then becomes how well these vaccines will work. It's very difficult to say. So, it looks like much of what we're doing in 2020 -- wearing masks, social distancing, washing hands, and staying safe -- will continue well into 2021.

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 Health Care Fund's annualized returns for the Institutional Shares as of September 30, 2020: 1-year, 48.86%; Since Inception (4/30/2018), 22.41%. Annual expense ratio for the Institutional Shares as of December 31, 2019 was 2.39%, but the net annual expense ratio was 0.85% (net of the Adviser's fee waivers). The **Russell 3000 Health Care Index**'s annualized returns as of September 30, 2020: 1-year, 24.60%; Since Fund Inception (4/30/2018), 14.53%.

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.

Risks: In addition to general market conditions, the value of the Fund will be affected by investments in health care companies which are subject to a number of risks, including the adverse impact of legislative actions and government regulations. 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 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 September 30, 2020 for securities mentioned are as follows:

Abbott Laboratories – 5.1%; **Roche Holding AG** – 3.7%; **Sanofi** - 4.1%; **AstraZeneca PLC** – 3.5%; **Illumina, Inc.** – 2.3%; **Guardant Health, Inc.** – 1.7%; **Adaptive Biotechnologies Corporation** – 0.7%; **10X Genomics, Inc.** – 1.1%; **Pacific Biosciences of California, Inc.** – 3.7%; **Schrodinger, Inc.** – 1.6%; **Veeva Systems Inc.** - 1.0%; **UnitedHealth Group Incorporated** – 6.6%; **Humana Inc.** – 3.9%; **Acceleron Pharma Inc.** – 4.6%.

Top 10 holdings as of September 30, 2020

Holding	% Assets
UnitedHealth Group Incorporated	6.6
Abbott Laboratories	5.1
Acceleron Pharma Inc.	4.6
Sanofi	4.1
Humana Inc.	3.9
Pacific Biosciences of California, Inc.	3.7
Roche Holding AG	3.7

AstraZeneca PLC	3.5
Thermo Fisher Scientific Inc.	3.5
argenx SE	3.0
Total	41.7

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

Russell 3000® Health Care Index is an unmanaged index representative of companies involved in medical services or health care in the Russell 3000 Index, which is comprised of the 3,000 largest U.S. companies as determined by total market capitalization. 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 performance is not fund performance; one cannot invest directly into an index.

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