



Mike Lippert: COVID-19 and the Acceleration of Secular Trends

This is an edited version of an October 28, 2020 Q&A with Mike Lippert, Portfolio Manager of Baron Opportunity Fund and Baron High Growth Strategy and Baron's Head of Technology Research. To access the full recording, please dial 800-633-8284, passcode #21969441.

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Overview of Fund performance

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Introduction

Mike Lippert manages Baron Opportunity Fund and Baron High Growth Strategy and is Baron's Head of Technology Research.

Baron Opportunity Fund has a 5-star Overall Morningstar Rating™. It has outperformed its benchmark, the Russell 3000 Growth Index, across all standard time periods since its February 29, 2000 inception. Its recent performance is also strong. The Fund return 75.82% for the 12-month period ended September 30, 2020 versus its benchmark's return of 36.12%. The third quarter continued the Fund's strong run of outperformance with a return of 17.92%, more than 500 basis points ahead of its benchmark's return of 12.86%.

For the period ended 9/30/2020, the Baron Opportunity Fund received a 5-Star Overall Morningstar Rating™, 5-Star 3-Year Rating, 5-Star 5-Year Rating, and 4-Star 10-Year Rating. The Morningstar Ratings are based on the Morningstar Risk-Adjusted Return measures of 1229, 1229, 1095, and 813 funds in the category, respectively. This Morningstar Rating is for the Institutional share class only; other classes may have different performance characteristics.

Morningstar calculates the Morningstar Large Growth Category Average using its Fractional Weighting methodology.

Q&A with Mike Lippert

Baron Opportunity Fund has done exceptionally well throughout the course of the pandemic. Could you talk about the drivers of that outperformance?

We didn't do anything different. We managed the portfolio the way we always do. For Baron Opportunity Fund, we focus on secular growth as opposed to cyclical growth. Cyclical growth is the up and down of the economy. It tends to impact certain industries and stock types more than others. It also has an impact on market psychology. Secular trends are bigger, more powerful, and more sustainable. They are multi-year trends that I sometimes refer to as generational or tectonic shifts.

One familiar example of a secular trend is computing, where we've gone through a mainframe era dominated by the likes of IBM [**International Business Machines Corporation (IBM)**] through a client/server/PC era dominated by the likes of **Microsoft Corporation (MSFT)** and **Intel Corporation (INTC)**. Now we are in the cloud computing era. A pioneer in cloud-based SaaS [software-as-a-service] is **salesforce.com, inc. (CRM)**, which delivers its applications through the cloud directly to its customers. On the infrastructure side, the number one cloud company is **Amazon.com, Inc. (AMZN)**. This may come as a surprise to many people and even some investors who think of Amazon as primarily an e-commerce company. Amazon initially built out its cloud

infrastructure to support its own services and apps but then realized it could offer this infrastructure to others. That's what started the infrastructure cloud computing era.

We invest in companies benefiting from these long-term, highly sustainable trends. We don't spend our time trying to predict the unpredictable – interest rates, economic conditions, geopolitics, regulations. Instead, we focus on the next inflection point of a secular trend, whether it is cloud computing, electric vehicles, e-commerce, digital media, renewables, genetics, or something else.

Within those trends, we look for innovative companies with durable competitive advantages that will allow them to capture market share and management teams who are aligned with our long-term thinking. We look for businesses where we think we can make a double in four to five years. 2020 has been an unusual year because the pandemic has accelerated many of the trends we were already invested in for years, and many of our companies have seen their share prices rise significantly as a result.

Let's talk about electric vehicles. Tesla, Inc. (TSLA) is currently your third largest holding. You also have a newer investment in a private electric vehicle company.

We've been researching or investing in the electric vehicle industry for over a decade. Even before Tesla, we were investing in companies that make the components of the batteries used in hybrids. Some of these investments were not successful, but the process taught us a lot. I think I first invested in Tesla sometime in 2014 and built up the position from there.

Without a doubt, Tesla is the pioneer and the leader of the electric vehicle trend today. Still, CEO Elon Musk continues to try to accomplish things many people say can't be done. With electric, Musk is focusing on both the vehicle and the battery. In its recent "Battery Day," Tesla outlined its roadmap for the next two years. The company is working on efficiencies and innovation not just for its electric vehicle batteries but also for storage batteries, which are critical for renewable energy because, obviously, sunlight and wind are both intermittent.

I actually bought my first Tesla recently. It is so much better than anything else I've ever driven in my life that it's a completely different experience. I'm not even sure what I could compare it to. It's fast, it accelerates quickly and handles very well. It also has regenerative braking, so the car slows down and brakes as you pull your foot off the accelerator. This means you're not switching back and forth between pedals. It's a safer, easier drive. You're less tired, particularly in traffic. That's just one element in addition to all the other innovations that make this car not only fabulous to drive but also one of the safest passenger cars in the world.

Of course, Tesla trades at a much higher multiple than legacy OEMs [original equipment manufacturers] like GM [**General Motors Company (GM)**] and **Ford Motor Company (F)**. I think that's the wrong comparison because the OEMs are grappling with significant secular challenges and disruption today. They are no longer operating in a massive growth industry like in the 1950s.

We focus on unit economics, or the revenues and costs in relation to an individual unit. In its most recent quarterly results, Tesla's gross margins, even excluding the revenue from electric car credits, were substantial, reflecting strong unit economics. For a Model Y or a Model 3, the ASP [average selling price] is somewhere between \$45,000 and \$50,000. We believe the ASP will probably trend down over the years because Musk wants to make these cars as affordable as possible. But Tesla is currently earning over \$10,000 in gross profit per vehicle, and this amount has been rising and is likely to rise more with further manufacturing efficiencies and the addition of autopilot, or a fully self-driving vehicle.

Tesla has obviously been a tremendous success for the Fund. We've made significantly more than a 10-bagger on our initial investment. Given Tesla's remarkable run up year-to-date, we felt it was appropriate to trim our weighting in the stock. That said, nothing has changed in our conviction in Tesla.

We've been researching electric cars a lot lately, talking to companies going public as well as privates. Out of all these companies, our only new investment so far is in **Rivian Automotive, Inc.**, a private company founded in 2009 and focused on autonomous electric vehicles. Early in 2019, Amazon, which is the Fund's top holding, announced it would be leading an investment round of \$700 million. Later that year, Amazon ordered 100,000 electric delivery vans from Rivian, with delivery to start in 2021. Amazon's involvement was an important

imprimatur for us. We also spent a lot of time with Rivian's management team.

We think Rivian is like Tesla, incredibly innovative and with a focus on vertical integration, meaning that it controls a lot of the technology and manufacturing of the parts that go into its vehicles. That was attractive to us. There are plenty of electric vehicle companies that are just middlemen pulling together component providers and other partners such as **Nikola Corporation (NKLA)**, which we did not invest in.

We've seen a big pick up in IPO activity in the last couple of quarters. Have you invested in any IPOs recently?

It's not surprising in this market. Record low interest rates, the market recovery, and the pandemic-driven acceleration in digitization has made it more attractive for companies operating in these digital transformation areas to go public.

We've participated in a number of recent IPOs but I will just highlight a couple since both are now top 10 positions in the portfolio. In September, we participated in the IPO of **Snowflake Inc. (SNOW)**, which provides a data-warehouse platform for large-scale data analytics and storage. We have been following this company for years. Snowflake's CEO and CFO came from **ServiceNow, Inc. (NOW)**, which has been a very successful long-term investment for us. We had spent significant time with the management team even before Snowflake decided to go public. Because of our positive relationship with management, we received a favorable allocation in the IPO. We believe Snowflake has a significant growth runway within its large addressable market given its differentiated technology, platform approach, and highly experienced management team.

Last quarter, we participated in the IPO of **ZoomInfo Technologies Inc. (ZI)**, which operates a cloud-based business-to-business intelligence platform to help salespeople identify and target prospects, shorten sales cycles, and increase win rates. This was another company we knew before it went public, and again, we received a favorable allocation. We believe ZoomInfo has a meaningful runway for growth supported by a secular shift to targeted, data-driven marketing and the company's go-to-market strategy.

You've touched on how the pandemic has accelerated certain secular trends. What do you foresee happening post-pandemic? Will we go back to the way things were?

The trends that have driven our portfolio forward this year and, I believe, will drive us forward for the next 10 years are essentially the same consistent trends. E-commerce, for example, has been a secular trend since the 1990s but experienced massive growth this year because of COVID-19. Last quarter, Amazon had unit growth over 50%. I don't pretend that that level of growth is sustainable; it is not. People will go to stores again when the world becomes safer. We're social beings, and we will return to many of ways we lived before the pandemic.

That said, I think the adoption curve of e-commerce has inflected. People who had never used e-commerce before or who had used it just on occasion are seeing how convenient e-commerce is, how you can save time, and how you can comparison shop and read user reviews to inform your purchase. Because of those new adopters, I think Amazon will reach our long-term valuations a bit earlier than our pre-pandemic projections.

Digital communications is another trend that has really broken out in the pandemic. Perhaps the best-known company in this area is **Zoom Video Communications, Inc. (ZM)**, which provides multi-participant video communications. We knew the company very well when it was private and invested in the IPO. We are also investors in **RingCentral, Inc. (RNG)**, a leader in UCaaS [Unified Communications as a Service], a phone/video/collaboration/contact center in the cloud. The company is in the early stages of disrupting the on-premises communications market. We've owned RingCentral for about three years, and it is currently a top 10 position.

Both Zoom Video and RingCentral have benefited tremendously from the need to be able to communicate anytime and anywhere as we continue to work, learn, and socialize remotely. Again, I believe part of this massive growth is not repeatable. There are certainly small businesses or individuals who will cancel their Zoom subscription post-pandemic. But I also think we've seen an inflection in digital communications during the pandemic. Companies are seeing the time, money, and hassle saved through communicating remotely.

What other companies have been outsized beneficiaries of the pandemic?

Because of the acceleration in digital transformation, the lion's share of our portfolio has performed very well. However, it's important to point out that none of these investments are based on new trends but rather a continuation and an acceleration of the digital transformation trends we've been investing in for many years.

Within social media, **Pinterest, Inc. (PINS)** and **Snap Inc. (SNAP)**, which operates SnapChat, stand out as top performers. Video game companies have done very well, which is expected with everybody at home. Cybersecurity companies like **CrowdStrike, Inc. (CRWD)**, which enables people to securely access and send data from any device and any location, have been incredibly successful. **Zillow Group, Inc. (Z)**, which operates online real estate sites, has done an amazing job of pivoting, enabling realtors to provide services completely digitally. Electronic payment companies like **PayPal Holdings, Inc. (PYPL)** that are more leveraged toward e-commerce has done very well this year. There are many others I could name.

Can you talk a bit about companies that have been negatively impacted by the pandemic?

One holding that has struggled is **Guidewire Software, Inc. (GWRE)**, a core-systems software provider to the property and casualty insurance industry. We've owned Guidewire probably since its 2011 IPO, and it has been the market leader for as long as we've been an investor. Guidewire has been transitioning to cloud-first, which has caused short-term headwinds as customers decided whether to stick with an on-premise self-managed product or convert to the cloud. Since we are talking about core systems, these are major changes.

When COVID-19 struck, customers turned their attention to digital communications and the security issues involved and back burned software upgrades to core systems. As a result, Guidewire has been a significant underperformer year-to-date. We still believe in Guidewire's long-term growth potential and added to our position on weakness. Even if the pandemic is prolonged, we believe business will accelerate over the next couple of years, driven by the inevitable need for P&C insurers to upgrade 30-year-old systems.

Another relative underperformer was **Ceridian HCM Holding Inc. (CDAY)**, a leading HCM [human capital management] and payroll software platform. With people getting laid off at the beginning of the pandemic, Ceridian's business suffered because it charges its customers using a per employee per month acronym known as PEPM. Revenues were also hurt by low interest rates because it made less interest on the float, or the time between the money going into the system and getting paid out. The competitive environment has improved because a competitor got taken out by private equity, and Ceridian is having a positive year. But compared to the software industry overall, Ceridian is an underperformer. Post-pandemic, we believe businesses like Ceridian will benefit as companies start hiring again. Of the 22 million people who lost their jobs during the pandemic, only 11 million have been hired back or found new jobs, so we're still 11 million jobs down from the peak.

Any final thoughts you'd like to leave us with?

I think the major issue for the markets is when the pandemic will end. I don't know. But I do think it will end sometime in the not-too-distant future. The most likely scenario is that we defeat the virus with the combination of a vaccine and much better treatments than we have today. We're already seeing improvement on the treatment side. Casualty rates are moving down. Every human being hopes we return to a more normal world.

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 September 30, 2020: 1-year, 75.82%; 5-years, 27.69%; 10-years, 18.12%; Since Inception (2/29/2000), 9.75%. Annual expense ratio for the Institutional Shares as of September 30, 2019 was 1.09%. The **Russell 3000 Growth Index's** annualized returns as of September 30, 2020: 1-year, 36.12%; 5-years, 19.51%; 10-years, 16.91%; Since Fund Inception (2/29/2000), 6.04%.

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.

The Fund's 3-month, 3-, 5- and 10-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 Fund's level of participation in IPOs and secondary offerings 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.

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.

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Portfolio holdings as a percentage of net assets as of September 30, 2020 for securities mentioned are as follows: **salesforce.com, inc.** – 1.1%; **Rivian Automotive, Inc.** – 0.7%; **ServiceNow, Inc.** – 1.1%; **Zoom Video Communications, Inc.** – 0.7%; **Pinterest, Inc.** – 1.6%; **Snaps Inc.** – 1.4%; **CrowdStrike, Inc.** – 1.1%; **Zillow**

Group, Inc. – 1.7%; **PayPal Holdings, Inc.** – 1.7%; **Guidewire Software, Inc.** – 1.7%; **Ceridian HCM Holding Inc.** – 1.1%.

The portfolio does not hold shares in **International Business Machines Corporation, Intel Corporation, General Motors Company, Ford Motor Company, or Nikola Corporation** as of September 30, 2020.

Top 10 holdings as of September 30, 2020

Holding	% Assets
Microsoft Corporation	7.6
Amazon.com, Inc.	6.9
Tesla, Inc.	3.7
Alphabet Inc.	3.7
Facebook, Inc.	3.0
ZoomInfo Technologies Inc.	2.6
Alibaba Group Holding Limited	2.6
RingCentral, Inc.	2.3
Snowflake Inc.	2.2
argenx SE	1.9
Total	36.5

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

The Russell 3000® Growth Index measures the performance of the broad growth segment of the U.S. equity universe comprised of the largest 3000 U.S. companies representing approximately 98% of the investable U.S. equity market, the **S&P 500 Index** of 500 widely held large-cap U.S. companies. The indexes and the Fund are with dividends, which positively impact the performance results. 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. Index performance is not fund performance. Investors cannot invest directly in an index.

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