One trillion dollars of doubt. This is how Bank of America's strategists recently labeled the sustained massive influx of cash into money market funds this year. It is, perhaps, also an accurate way to describe the current state of investor sentiment. This letter is not about having doubt in our financial markets; it is about investing with conviction.

Money market assets reached a new all-time high in the third quarter, after raking in nearly a trillion dollars since October 2022, according to data from Morningstar. Interest rates above 5%, the inverted yield curve, an uncertain monetary policy path, and persistent concerns of economic slowdown have been the main drivers of the steady money market inflows for 12 consecutive months.

Despite investor uncertainty, the S&P 500 Index has increased 20% since its low a year ago, and economic data has been more robust than expected. Yet, U.S. equity funds across all Morningstar style box categories have seen net outflows of $100 billion since then, not including another $46 billion of outflows from sector funds. Flows for actively managed funds have been negative. Flows for passively managed funds were positive in almost all categories; but, by far, the bulk of net inflows went to the Large Blend category, where the most popular indexed products are classified. What is more interesting, just six ETFs and index funds accounted for the entire $113 billion inflow in the Large Blend category over the past 12 months. Other passively managed products also had positive flows, but they offset the negatives in the category, in the aggregate.

Equity Flows Have Been Mostly Directed to Passively Managed Large Blend Products

One-Year Cumulative Net Fund Flows by Morningstar Category
as of 9/30/2023, in billions

Actively Managed Funds

	Value	Blend	Growth
Large	-$54	-$52	-$93
Mid	-$17	-$3	-$24
Small	-$1	-$7	-$12

Passively Managed Funds

	Value	Blend	Growth
Large	-$9	$113	$28
Mid	$4	$11	$1
Small	$2	$12	$1

Source: Morningstar Direct.

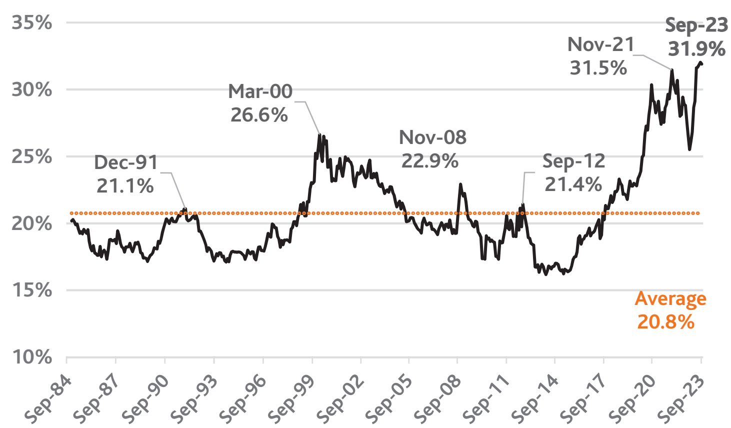
Over the past 15 years, passive products, especially those tracking the most popular stock market indexes like the S&P 500 Index, have become an integral part of most investor portfolios. They have been a reasonable tool for gaining broad and diversified equity market exposure. However, because several mega-cap stocks have recently performed significantly better than the rest of the stocks in the asset class, those indexes and the products that track them have become unusually concentrated in a handful of stocks. This may be surprising to some investors.

LINDA MARTINSON
CHAIRMAN, PRESIDENT AND COO

The chart below shows that as of 9/30/2023, nearly a third of the weight in the S&P 500 Index was concentrated in the top 10 (out of 504) stocks. This is the most concentrated the index has been in at least four decades, and significantly above the 20.8% historical average weight of the top 10 index constituents.

The S&P 500 Index Has Reached the Highest Level of Concentration in Decades

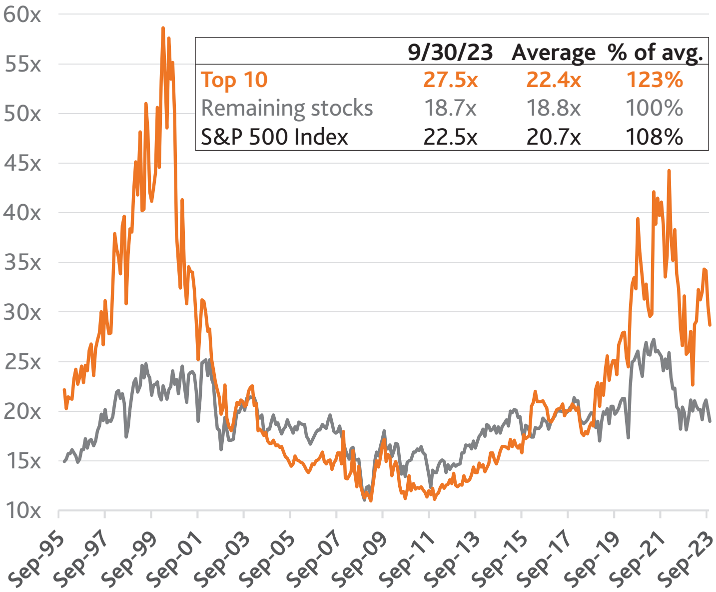
Combined Weight of Top 10 Largest Holdings in the S&P 500 Index
12/31/1984 – 9/30/2023, monthly



Source: FactSet.

Furthermore, due to recent strong performance, the valuations of the top 10 have significantly outgrown the valuations of the remaining index constituents, as shown by the next chart. The top 10 stocks are currently trading at a 23% valuation premium relative to the average valuation for the top 10.

Next 12 Months P/E Ratio of the Top 10 and the Remaining Stocks in the S&P 500 Index
12/31/1995 – 9/30/2023, monthly



Source: FactSet Fundamentals.

As the chart from the prior page further shows, the combined weight of the top 10 holdings in the S&P 500 Index has varied substantially throughout the past four decades. This is an outcome of index design – the maximum weight any single stock can have is directly linked to its market capitalization, both of which, technically, can grow without limit. This is a particular feature of large-cap indexes. Most popular mid-cap and smaller cap equity indexes have some implicit limitation on concentration, since the larger cap stocks would be moved to a larger cap index at the next rebalancing.

Concentration per se is not necessarily a bad thing, although it generally means a portfolio may be subject to higher risk. Periodically, the unmanaged products that track the large-cap indexes build up concentration which, as a result, may build up pressures and higher uncontrolled risk for passive investors. Actively managed concentrated[1] portfolios are also subject to high risk, but this risk is intentionally taken by the manager and can be controlled to some extent. We believe the decision to take this risk and the ability to manage it are key to successfully managing a more concentrated portfolio. Only an active manager can do this.

Typically, a concentrated portfolio holds a small number of stocks and/or is invested heavily in a few holdings. If these stocks do well, they will drive the performance of the portfolio and can potentially lead to substantial outperformance. This would often be the main reason an investor would pick a concentrated fund – the desire to generate outsized returns. However, concentrated portfolios inherently carry higher risk that can result in outsized underperformance and losses.

The degree of concentration in a portfolio may be a result of different factors. For the S&P 500 Index, it is caused by the past performance of its constituents. For actively managed portfolios, it is likely due to active allocation decisions by the portfolio manager based on experienced analysis. Conviction is derived from the level of confidence in that analysis.

Conviction is having a strong belief in the fundamental underlying value and growth prospects of an investment, based on thorough and ongoing research and analysis. Investors with high conviction believe that their investment in a particular stock, asset, market sector, or investment strategy has a solid foundation and is likely to succeed over the long term, despite market volatility or contrary opinions.

The connection between conviction and concentrated portfolios in investing lies in the confidence investors have in their selected investments. When investors have a high level of conviction, they may feel strongly enough about their research and the potential of certain investments to allocate a significant portion of their capital to them, leading to a more concentrated portfolio.

In our view, the long-term success of concentrated equity portfolios mostly hinges on the portfolio manager's stock selection skill. Skilled investors are those who can consistently deliver value to their investors and are among the best across peers. Having expertise over many years, and knowing its depth and boundaries, is what allows skilled managers to make high-conviction investment decisions. Nevertheless, even the best managers know they can't make great decisions all the time, which is why they seek some diversification. As Howard Marks wrote in one of his memos[2], portfolio managers "may overweight favorites to take advantage of what they think they know, but they still diversify to protect against what they don't know."

If concentration risk is altogether undesired, the solution is to invest in diversified products. Diversification, called by Nobel Prize laureate Harry Markowitz "the only free lunch" in investing, can help reduce the idiosyncratic risk in a portfolio. Every stock portfolio is subject to market fluctuations and risks that are unavoidable. The stock-specific risks in a portfolio, however, can be reduced by adding more stocks. Broadly speaking, the amount of stock-specific risk is inversely proportional to the number of portfolio holdings. But as with most things in investing, every solution brings a new problem – in this case, it is the risk of overdiversification.

Overdiversification occurs when a portfolio holds such a large number of stocks that the intended benefits of diversification start to level off and even become detrimental to the overall portfolio. The principal downside of overdiversification is the dilutive impact on the outperforming stocks.

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[1] *In this context, and throughout the letter, we do not use the word concentrated as defined in the Investment Company Act of 1940. We use it more broadly, to discuss portfolios that tend to allocate significantly to a small number of stocks and/or have a small number of holdings in general.*
[2] *See "Selling Out" from 1/13/2022, available at oaktreecapital.com.*

It can also result in redundant (thus, highly correlated) asset choices, higher transaction costs, and increased portfolio management complexity. Striking a balance between adequate diversification and focused investing to achieve potential outperformance is key.

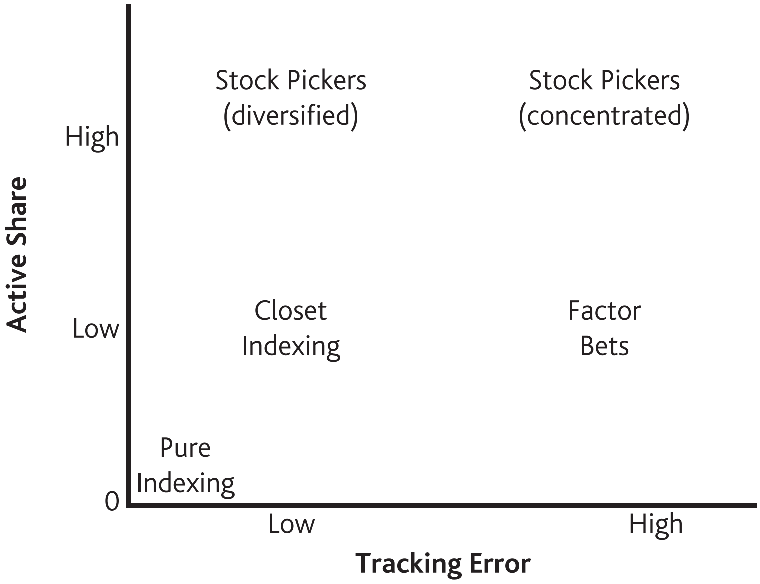
So, how many stocks are sufficient to optimally diversify a stock portfolio? Research shows that over the past 70 years there have been about 150 journal publications attempting to provide an answer to this question, most of which were published in the last decade. A review[3] of these concluded that there isn't a single number corresponding to an optimal number of stocks that constitute a well-diversified portfolio. Optimal diversification is influenced by a variety of factors, including market conditions, market capitalization, asset class and the size of the investment universe, investor characteristics, the change over time of the assets features, and the way risk is measured, among others.

Concentrated portfolios are generally considered riskier than diversified portfolios. However, this is not always true. A diversified portfolio invested in a significantly larger number of stocks that are highly correlated or with significant exposure to a particular style or industry factors may provide a much less attractive balance of risks. Achieving an attractive balance of risks can be done through active decision making. Only an active manager can effectively control risk, although few can do this skillfully and consistently. When searching for a skilled manager, we believe that evaluating a manager's track record over long periods of time is important, but understanding the investment philosophy and process is also key.

To increase the possibility of generating above-average returns, investors should first make sure the manager is truly active. Active share is a commonly used metric to distinguish between truly active managers and closet indexers by determining the percentage of stock holdings in a manager's portfolio that differs from the benchmark index. If a large portion of a fund's performance can be attributed to simply mirroring an index, then the manager is likely just a "closet indexer." An active share of 0% would mean the fund perfectly mirrors its benchmark (e.g., an index fund), and an active share of 100% would mean the fund has no overlap with its benchmark at all. Generally, funds investing in broader universes with an active share over 60% are considered moderately active, and funds with an active share over 80% are highly active. Funds investing in narrower universes, like sector funds, may have active share of 50% - 60% and still be considered active.

Using active share in conjunction with another common metric, tracking error, can provide a more comprehensive view of a fund's management style and investment strategy, as summarized by the next diagram. Tracking error measures the volatility of a fund's excess return versus a benchmark. Low tracking error means that a fund's performance is very similar to that of the benchmark, which may be an indication that the portfolio is nearly identical to the benchmark. A fund with high tracking error is likely making investments and taking on risks that are materially different from those of its benchmark resulting in performance that meaningfully deviates from the benchmark's. If active share is low, yet tracking error is high, it is possible the manager is taking large, concentrated positions in a smaller universe (i.e., a sector).

Active Share and Tracking Error Can Help Identify the Truly Active Funds



Source: Cremers, Martijn and Petajisto, Antti, How Active is Your Fund Manager? A New Measure That Predicts Performance (March 31, 2009) Original working paper circulated in 2006.

Active share and tracking error can give a general idea of the fund's management style, but they are far from sufficient to uncover all potential risks in a portfolio. High tracking error can be an indication of high relative concentration, but it will not capture absolute concentration risk of an index fund or an ETF tracking the S&P 500 Index. Additional metrics, such as number of portfolio holdings, percent of assets invested in the top holdings, and diversity of sector and industry exposures can provide a more thorough assessment of concentration risk. In addition, risk-adjusted metrics, such as Sharpe ratio and Sortino ratio, can be helpful when evaluating whether the extra risk from concentration has been justified.

Both concentrated and diversified funds can provide value to investors. Ultimately, whether to choose one type of fund over the other, or to allocate to both types, would depend on the investor's risk appetite. Either way, know what you're investing in and make sure that the risks and exposures of a product have been intentionally taken and are adequately managed. There is no guarantee that this will result in outperformance, but finding a skilled manager with a time-tested investment approach should increase the chances.

[3] *Zaimovic, Azra, Adna Omanovic, and Almira Arnaut-Berilo. 2021. How Many Stocks Are Sufficient for Equity Portfolio Diversification? A Review of the Literature. Journal of Risk and Financial Management 14: 551.*

Baron Capital's Approach to High-Conviction Investing

Conviction-based investing is at the core of Baron Capital's portfolio construction and management processes. Our strongest skill is our ability to thoroughly research and understand the inner workings of a business, analyze its growth trajectory and competitive advantages and how robust they are, and assess how qualified and motivated management is. To paint a comprehensive picture, we put all these key factors – and more – through our long-term lenses and evaluate how businesses may benefit from the secular trends we have identified and researched. This is how we gain conviction in our investments. Our portfolio managers' conviction is directly reflected by the portfolio weights they assign to individual companies. And, without exception, our portfolio managers put substantial weight on their highest conviction positions.

Conviction is not merely the determinant of Baron Capital's portfolio weights; it is also an integral risk management mechanism. While diversification is traditionally associated with risk reduction, we believe that investing more in the companies we know best results in lower risk. Thus, at Baron Capital, conviction-based investing is less a strategy and more a philosophy – a philosophy that honors the depth of insight over the breadth of selection.

As the table below shows, all Baron mutual funds have significant allocation to their top 10 stocks, and all Funds have invested in a small number of stocks relative to their investment universe. This data is a testament to Baron Capital's high conviction active approach. In addition, our Funds tend to invest in fewer stocks relative to their respective Morningstar category peers and have higher active share and tracking error.

High-Conviction Investing is at the Core of Baron Capital's Portfolios

Measures of Conviction for the Baron Funds
as of 9/30/2023

Morningstar Category *(Prospectus Classification)*	Fund Name	Morningstar Category Benchmark	Inception Date	Active Share	3-Yr Tracking Error vs. Primary Benchmark	% Weight of Top 10 Stocks	% Weight of Top 10 Stocks (5Yr Average)	Number of Stocks[1]	Number of Stocks (5Yr Average)	# Stocks in Category Benchmark	Fund Stocks as% of Category Benchmark
Small Growth *(Diversified)*	Baron Small Cap Fund®	Russell 2000 Growth Index	9/30/97	96.2%	9.2%	39%	31%	64	73	1,084	5.9%
	Baron Discovery Fund®	Russell 2000 Growth Index	9/30/13	96.3%	6.9%	30%	28%	58	68	1,084	5.4%
	Peers Average	*Russell 2000 Growth Index*		*87.7%*	*6.9%*	*22%*	*7%*	*213*	*160*	*1,084*	*19.6%*
Midcap Growth *(Diversified)*	Baron Growth Fund®	Russell Midcap Growth Index	12/30/94	99.2%	9.6%	65%	56%	39	50	335	11.6%
	Baron Asset Fund®	Russell Midcap Growth Index	6/12/87	82.6%	5.7%	47%	41%	50	58	335	14.9%
	Peers Average	*Russell Midcap Growth Index*		*79.9%*	*5.8%*	*25%*	*6%*	*242*	*148*	*335*	*72.3%*
Midcap Growth *(Non-Diversified)*	Baron Focused Growth Fund®	Russell 2500 Growth Index	6/30/08[2]	98.4%	12.9%	57%	73%	33	24	335	9.9%
	Peers Average	*Russell Midcap Growth Index*		*94.8%*	*17.8%*	*39%*	*54%*	*71*	*47*	*335*	*21.1%*
Large Growth *(Diversified)*	Baron Opportunity Fund®	Russell 3000 Growth Index	2/29/00	64.3%	10.5%	53%	43%	49	59	446	11.0%
	Baron Fifth Avenue Growth Fund®	Russell 1000 Growth Index	4/30/04	79.2%	11.5%	59%	51%	30	34	446	6.7%
	Baron Durable Advantage Fund®	S&P 500 Index	12/29/17	73.0%	6.0%	53%	47%	30	33	446	6.7%
	Peers Average	*Russell 1000 Growth Index*		*59.2%*	*5.4%*	*41%*	*5%*	*125*	*117*	*446*	*28.1%*
Large Growth *(Non-Diversified)*	Baron Partners Fund®	Russell Midcap Growth Index	4/30/03[3]	94.6%	24.7%	88%[4]	94%	21	28	446	4.7%
	Peers Average	*Russell 1000 Growth Index*		*57.4%*	*5.7%*	*47%*	*49%*	*148*	*115*	*446*	*33.1%*
International / Global Funds *(Diversified)*	Baron Emerging Markets Fund®	MSCI EM Index	12/31/10	72.9%	4.7%	31%	26%	95	103	1,437	6.6%
	Baron International Growth Fund®	MSCI ACWI ex USA Growth Index	12/31/08	87.2%	5.7%	22%	20%	100	103	1,303	7.7%
	Baron New Asia Fund®	MSCI AC Far East ex Japan Index	7/30/21	69.2%	n/a	34%	n/a	74	n/a	1,122	6.6%
	Baron Global Advantage Fund®	MSCI ACWI Growth Index	4/30/12	96.0%	18.5%	58%	41%	38	49	1,579	2.4%
	Peers Average	*Categories' Benchmarks Average*		*80.4%*	*6.7%*	*30%*	*6%*	*363*	*224*	*1,360*	*26.7%*
Sector Funds *(Diversified)*	Baron Real Estate Fund®	S&P United States REIT Index	12/31/09	76.2%	8.1%	48%	41%	37	46	84	44.0%
	Peers Average	*S&P United States REIT Index*		*54.9%*	*3.9%*	*43%*	*41%*	*83*	*76*	*84*	*99.0%*
Sector Funds *(Non-Diversified)*	Baron Real Estate Income Fund®	S&P United States REIT Index	12/29/17	52.4%	5.0%	61.3%	48.6%	28	36	84	33.3%
	Baron Health Care Fund®	S&P 1500 Health Care Index	4/30/18	58.8%	7.5%	49.8%	42.4%	38	48	170	22.4%
	Baron FinTech Fund®	Morningstar US Tech Index	12/31/19	85.6%	n/a	41%	n/a	45	n/a	235	19.1%
	Baron Technology Fund®	Morningstar US Tech Index	12/31/21	64.5%	n/a	54%	n/a	42	n/a	235	17.9%
	Peers Average	*Categories' Benchmarks Average*		*69.0%*	*7.5%*	*54%*	*54%*	*65*	*67*	*163*	*40.2%*

Source: Morningstar Direct, FactSet PA, Baron Capital.
Note: Not including Baron Wealth Building Fund, which is a fund of funds.
The Peers Average figures were calculated as the simple average of the diversified or non-diversified share classes available in the Morningstar category where each Baron Fund was classified as of 9/30/2023. For the International/Global (Diversified) Peers Average, the following Morningstar categories were combined for the calculations: US Fund Diversified Emerging Markets, US Fund Foreign Large Growth, US Fund Pacific/Asia ex-Japan, and US Fund Global Large — Stocks Growth. For the Sector Funds (Non-Diversified) Peers Average the following Morningstar categories were combined for the calculations: US Fund Real Estate, US Fund Health, and US Fund Technology.
1 - The number of stocks presented does not include private securities.
2 - Baron Focused Growth Fund began operations as a partnership on May 31, 1996. The Fund registered under the Investment Company Act of 1940 as a registered investment company effective June 30, 2008.
3 - Baron Partners Fund began operations as a partnership on January 31, 1992. The Fund registered under the Investment Company Act of 1940 as a registered investment company effective April 30, 2003.
4 - Percentage of total investments.

Baron Capital's high conviction investment approach has always been the backbone of our business, even during uncertain times. Our long-term view helps us filter out the noise and maintain focus on fundamentals, giving us confidence in what we do. The current investor uncertainty and flows to defensive assets do not influence our strategy. Our 40 years of experience has reinforced our confidence in our philosophy, and history has shown that it is a matter of time before investors direct flows back to equities.

Sincerely,

Linda S. Martinson
Chairman, President, and COO
September 30, 2023

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 1-800-99-BARON or visiting baronfunds.com. Please read them carefully before investing.

Risks: All investments are subject to risk and may lose value.

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.

Diversification does not guarantee a profit or protect against a loss.

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

The **S&P 500 Index** measures the performance of 500 widely held large-cap U.S. companies. The Fund includes reinvestment of dividends, net of withholding taxes, while the S&P 500 Index includes reinvestment of dividends before taxes. Reinvestment of dividends positively impacts the performance results. The index is unmanaged. Index performance is not Fund performance. Investors cannot invest directly in an index.

Price/Earnings Ratio (next 12-months): is a valuation ratio of a company's current share price compared to its mean forecasted 4 quarter sum earnings per share over the next twelve months. If a company's EPS estimate is negative, it is excluded from the portfolio-level calculation. Sharpe Ratio is a risk-adjusted performance statistic that measures reward per unit of risk. The higher the Sharpe ratio, the better a fund's risk adjusted performance. The **Sortino Ratio** is a variation of the **Sharpe ratio** that differentiates harmful volatility from total overall volatility by using the asset's standard deviation of negative portfolio returns–downside deviation–instead of the total standard deviation of portfolio returns. **Standard Deviation** (Std. Dev) measures the degree to which a fund's performance has varied from its average performance over a particular time period. The greater the standard deviation, the greater a fund's volatility (risk).

Stock-specific risk is the risk that is unique to a specific company. It is also known as non-systematic risk, diversifiable risk, or residual risk.

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