

## DEAR BARON HEALTH CARE FUND SHAREHOLDER:

## PERFORMANCE

In the quarter ended December 31, 2024, Baron Health Care Fund® (the Fund) declined 9.58% (Institutional Shares), compared with the 9.75% decline for the Russell 3000 Health Care Index (the Benchmark) and the 2.63% gain for the Russell 3000 Index (the Index). For the full year 2024, the Fund increased 1.55% compared with the 3.48% gain for the Benchmark and the 23.81% gain for the Index. Since inception (April 30, 2018), the Fund increased 10.82% on an annualized basis compared with the 9.32% gain for the Benchmark and the 13.91% gain for the Index.

Table I.  
Performance

Annualized for periods ended December 31, 2024

	Baron Health Care Fund Retail Shares <sup>1,2</sup>	Baron Health Care Fund Institutional Shares <sup>1,2</sup>	Russell 3000 Health Care Index <sup>1</sup>	Russell 3000 Index <sup>1</sup>
Three Months <sup>3</sup>	(9.61)%	(9.58)%	(9.75)%	2.63%
One Year	1.31%	1.55%	3.48%	23.81%
Three Years	(3.75)%	(3.52)%	(0.02)%	8.01%
Five Years	8.70%	8.95%	7.18%	13.86%
Since Inception (April 30, 2018)	10.55%	10.82%	9.32%	13.91%

In a difficult quarter for the broader Health Care sector, the Fund performed roughly in line with the Benchmark. The Fund failed to separate itself from the Benchmark because favorable impacts from stock selection and cash exposure in a down market were mostly offset by adverse impacts from differences in sub-industry weights.

Apart from cash, stock selection was positive overall due to solid gains from a handful of holdings in health care equipment, biotechnology, life sciences tools & services, and health care services. Stock selection in health care equipment was an 80-plus basis point tailwind to performance owing to modest gains from the Fund's large positions in global medical device manufacturer **Boston Scientific Corporation** and robotic surgical system



NEAL KAUFMAN

PORTFOLIO MANAGER

Retail Shares: BHCFX  
Institutional Shares: BHCHX  
R6 Shares: BHCUX

leader **Intuitive Surgical, Inc.** We discuss reasons for Boston Scientific's contribution below. Intuitive's quarterly revenue and earnings surpassed Street expectations due to strong systems placements and procedure growth. The company remains in the early stages of a new product cycle with its new da Vinci 5 system, and we continue to believe the company has a long runway for growth driven by continued adoption and expansion of robotic surgery.

**Argenx SE** contributed the vast majority of relative gains in biotechnology after the company's shares appreciated double digits in the period. We discuss the company in greater detail below.

Strength in life sciences tools & services and health care services came from cell-free DNA testing leader **Natera, Inc.** and diagnostic imaging services provider **RadNet, Inc.**, respectively. Natera was a top contributor after reporting blowout quarterly results, while RadNet's shares outperformed in

*Performance listed in the above table is net of annual operating expenses. The gross annual expense ratio for the Retail Shares and Institutional Shares as of December 31, 2023 was 1.20% and 0.88%, respectively, but the net annual expense ratio was 1.10% and 0.85% (net of the Adviser's fee waivers), respectively. 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 waives and/or reimburses certain Fund expenses pursuant to a contract expiring on August 29, 2035, 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 [BaronCapitalGroup.com](http://BaronCapitalGroup.com) or call 1-800-99-BARON.*

<sup>1</sup> The **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. The **Russell 3000® Index** measures the performance of the broad 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. All rights in the FTSE Russell Index (the "Index") vest in the relevant LSE Group company which owns the Index. Russell® is a trademark of the relevant LSE Group company and is used by any other LSE Group company under license. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. The Fund includes reinvestment of dividends, net of withholding taxes, while the Russell 3000® Health Care and Russell 3000® Indexes include reinvestment of dividends before taxes. Reinvestment of dividends positively impacts the performance results. The indexes are unmanaged. Index performance is not Fund performance. Investors cannot invest directly in an index.

<sup>2</sup> The performance data in the table does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or redemptions of Fund shares.

<sup>3</sup> Not annualized.



# Baron Health Care Fund

response to solid quarterly results, raised full-year guidance, and the announcement of an attractive strategic collaboration with GE HealthCare to further the innovation and adoption of AI-powered solutions in imaging through RadNet's DeepHealth platform.

Mostly offsetting the above was weakness in pharmaceuticals related to not owning shares of Benchmark heavyweight Bristol-Myers Squibb Company, whose shares increased 10.5% in the period, accounting for nearly half of the relative shortfall in the sub-industry. Poor performance from **AstraZeneca PLC** also factored into the underperformance in pharmaceuticals. The company is currently dealing with several ongoing investigations into employees in its China business. We believe shares are undervalued relative to what remains an attractive long-term growth outlook driven by indication expansion for current products (Tagrisso and Enhertu) as well as a range of pipeline assets.

Disappointing stock selection in health care facilities coupled with higher exposure to this lagging sub-industry also weighed on performance. **HCA Healthcare, Inc.** and **Tenet Healthcare Corporation** were mostly responsible for relative losses in health care facilities after their share prices declined alongside other hospital operators following Donald Trump's victory in the U.S. presidential election. We discuss these stocks below.

Our strategy is to identify competitively advantaged growth companies that we can own for years. Similar to the other Baron Funds, we remain focused on finding businesses that we believe have secular growth opportunities, durable competitive advantages, and strong management teams. We conduct independent research and take a long-term perspective. We are particularly focused on businesses that solve problems in health care, whether by reducing costs, enhancing efficiency, and/or improving patient outcomes.

We continue to think the Health Care sector will offer attractive investment opportunities over the next decade and beyond. Health Care is one of the largest and most complex sectors in the U.S. economy, accounting for an estimated 17.6% of GDP in 2023 and encompassing a diverse array of sub-industries. Health Care is also a dynamic sector undergoing changes driven by legislation, regulation, and advances in science and technology. We think navigating these changes requires investment experience and sector expertise, which makes the Health Care sector particularly well suited for active management.

**Table II.**  
**Top contributors to performance for the quarter ended December 31, 2024**

	Contribution to Return (%)
argenx SE	0.70
Natera, Inc.	0.44
Boston Scientific Corporation	0.35
Intuitive Surgical, Inc.	0.30
Glaukos Corporation	0.18

**Argenx SE** is a biotechnology company best known for developing Vyvgart, the leading FcRn inhibitor for the treatment of autoimmune conditions. Shares increased as Vyvgart continued its launch in generalized myasthenia gravis and got off to a strong start in chronic inflammatory demyelinating polyneuropathy. In addition, argenx recently announced that Vyvgart appears to be efficacious in three subsets of myositis (a group of rare autoimmune conditions that cause muscle inflammation) in a Phase 2

clinical trial and moved the drug into Phase 3. Over time, we expect Vyvgart to demonstrate efficacy in an ever-expanding range of autoantibody-driven autoimmune conditions. We expect Vyvgart to continue to launch well in its existing indications and the addressable market to expand as the drug is developed in additional indications.

**Natera, Inc.** is a diagnostics company for women's health, organ transplant diagnostics, and oncology. Natera offers a personalized blood-based DNA test called Signatera, which, by detecting how much residual cancer DNA remains in the body, helps doctors determine whether post-surgery chemotherapy is needed and monitor for cancer recurrence before it is detectable with standard imaging. Shares increased on blowout quarterly results, with outsized growth in the Signatera business and robust gross margin progression overall. We think Signatera is in the early innings of adoption in a market estimated at more than \$20 billion and will ultimately change the standard of care. We see a long runway for growth with expanding margins and profitability.

**Boston Scientific Corporation** is a global manufacturer of devices used in a broad range of interventional medical specialties. Shares climbed steadily throughout the quarter on solid company fundamentals, including a double-digit EPS growth profile and cost discipline that produces more than 50 basis points of annual operating margin expansion. We believe Boston Scientific can see sustainable organic growth in the high single digits, driven by differentiated products in electrophysiology and structural heart, in particular, the emerging field of pulsed field ablation (PFA), where the company is well positioned. Temperature-based methods (either hot or cold) to disable heart tissue responsible for irregular heartbeats can damage surrounding tissue. PFA relies on electricity to damage aberrant tissue, and because different types of tissue have different electrical thresholds, the surrounding tissue can be selectively spared. In our opinion, Boston Scientific is a compelling name within the large-cap medical device universe.

**Table III.**  
**Top detractors from performance for the quarter ended December 31, 2024**

	Contribution to Return (%)
UnitedHealth Group Incorporated	-1.18
Eli Lilly and Company	-1.10
Thermo Fisher Scientific Inc.	-0.80
Vertex Pharmaceuticals Incorporated	-0.77
HCA Healthcare, Inc.	-0.75

Shares of **UnitedHealth Group Incorporated**, the largest health care company by revenue, were volatile in the quarter. Quarterly medical cost trends ran higher than expected, the high end of quarterly guidance was cut, and the preliminary 2025 outlook missed consensus. The Republican November election sweep drove shares up, as Republicans have historically been more supportive of managed care, which bodes especially well for Medicare Advantage, the industry's main growth engine. In December, UnitedHealth's CEO was shot and killed, and the subsequent outpouring of public anger over the managed care industry's history of claims denials sparked concern about the industry's ability to control health care spend. The specter of pharmacy benefit manager (PBM) legislation was an additional pressure along with multiple press pieces questioning managed care practices and profit drivers. Longer term, we believe managed care will remain embedded in the U.S. health care system and UnitedHealth, as the largest, best managed, and most disciplined and forward-thinking company in the industry, will continue to grow.

**Eli Lilly and Company** is a global pharmaceutical company best known for developing and selling GLP-1 medications for diabetes and obesity. Shares detracted from performance as recent GLP-1 revenue results missed heightened expectations. We view Lilly's Mounjaro/Zepbound GLP-1/GIP drug as an important treatment for diabetic and non-diabetic obese patients and see Lilly continuing to innovate and develop more effective and convenient next-generation medications. Although manufacturing supply and access is limited in the near term, we think this class of drug should be the standard of care for both diabetes and obesity and will become a \$150 billion category. We think the recent revenue miss related to the mistiming of demand-generation activities with supply increases and elevated investor expectations after a very strong result in the prior quarter. We think this market is in the early innings of uptake and the adoption of GLP-1s will triple Lilly's total revenues by 2030.

**Thermo Fisher Scientific Inc.** is a life sciences company that offers instruments/consumables for research, tools for bioproduction, specialty diagnostics, and contract research and manufacturing services. Shares fell on underwhelming quarterly results marked by cautious commentary around China, biopharmaceutical project progression, and equipment purchases. The election of Trump and his selection of Robert F. Kennedy, Jr. to head Health and Human Services also pressured shares as they introduced an element of uncertainty into health care regulation and life science funding. We retain conviction as Thermo Fisher is dominant across multiple end markets and its scale gives it resilience. Once the macro environment normalizes, we expect an organic growth profile in the high single-digit range along with double-digit EPS growth.

## PORTFOLIO STRUCTURE

We build the portfolio from the bottom up, one stock at a time, using the Baron investment approach. We do not try to mimic an index, and we expect the Fund to look very different than the Benchmark. We loosely group the portfolio into three categories of stocks: earnings compounders, high-growth companies, and biotechnology companies. We define earnings compounders as companies that we believe can grow revenue at least mid-single digits and compound earnings at double-digit rates over the long term. We define high-growth stocks as companies we expect to generate double-digit or better revenue growth. They may not be profitable today, but we believe they can be highly profitable in the future. We expect the portfolio to have a mix of earnings compounders, high-growth, and biotechnology companies.

We may invest in stocks of any market capitalization and may hold both domestic and international stocks. As of December 31, 2024, we held 37 stocks. This compares with 532 stocks in the Benchmark. International stocks represented 9.1% of the Fund's net assets. The Fund's 10 largest holdings represented 61.1% of net assets. Compared with the Benchmark, the Fund was overweight in biotechnology, life sciences tools & services, health care equipment, and health care supplies, roughly equal weight in health care facilities, and most underweight in pharmaceuticals, health care services, and managed health care. The market cap range of the investments in the Fund was \$1.3 billion to \$733 billion with a weighted average market cap of \$174 billion. This compared with the Benchmark's weighted average market cap of \$225 billion.

We continue to invest in multiple secular growth themes in Health Care, such as genomics/genetic testing/genetic medicine, innovative medical devices that improve outcomes and/or lower costs, minimally invasive surgery, anti-obesity medications, *picks and shovels* life sciences tools providers, the shift to lower cost sites of care, and animal health, among others. To be clear, this list is not exhaustive: we own stocks in the portfolio that do not fit neatly into these themes and there are other themes not mentioned here that are in the portfolio. We evaluate each stock on its own merits.

**Table IV.**

**Top 10 holdings as of December 31, 2024**

	Year Acquired	Market Cap When Acquired (\$ billions)	Quarter End Market Cap (\$ billions)	Quarter End Investment Value (\$ millions)	Percent of Net Assets (%)
UnitedHealth Group Incorporated	2018	227.2	465.5	16.4	8.5
Intuitive Surgical, Inc.	2018	49.9	185.9	15.8	8.2
Eli Lilly and Company	2021	187.4	732.9	15.4	8.0
argenx SE	2018	2.8	37.1	14.5	7.5
Boston Scientific Corporation	2023	73.4	131.6	14.2	7.3
Thermo Fisher Scientific Inc.	2019	117.4	199.0	10.4	5.4
Arcellx, Inc.	2023	1.9	4.1	9.4	4.9
Stryker Corporation	2023	98.8	137.3	7.9	4.1
Vertex Pharmaceuticals Incorporated	2022	61.4	103.7	7.2	3.7
Danaher Corporation	2022	202.9	165.8	6.9	3.6

**Table V.**

**Fund investments in GICS sub-industries as of December 31, 2024**

	Percent of Net Assets (%)
Biotechnology	25.1
Health Care Equipment	23.9
Life Sciences Tools & Services	14.9
Pharmaceuticals	11.1
Managed Health Care	10.0
Health Care Supplies	2.9
Health Care Facilities	2.0
Health Care Services	1.3
Cash and Cash Equivalents	8.9
<b>Total</b>	<b>100.0*</b>

\* Individual weights may not sum to the displayed total due to rounding.

# Baron Health Care Fund

## RECENT ACTIVITY

During the December quarter, we added five new positions and exited eight positions. Below we discuss some of our top net purchases and sales.

Table VI.  
Top net purchases for the quarter ended December 31, 2024

	Quarter End Market Cap (\$ billions)	Net Amount Purchased (\$ millions)
HealthEquity, Inc.	8.3	2.8
Edgewise Therapeutics, Inc.	2.5	1.8
Insmmed Incorporated	12.4	1.4
Wave Life Sciences Ltd.	1.9	1.3
Arcellx, Inc.	4.1	1.1

We re-established a position in **HealthEquity, Inc.**, a leading provider and custodian of health savings accounts (HSAs) and other consumer-directed benefits (CDBs). HSAs offer a way for consumers to save money in a tax advantaged manner to pay for future health care expenses. HSAs have “triple tax” benefits: (1) individuals can claim a tax deduction for contributions they make; (2) the interest or earnings on assets in the accounts accumulate without being subject to tax; and (3) distributions are tax free if they are used to pay for qualified medical expenses.

HealthEquity is one of the largest custodians of HSAs as measured by accounts and assets. As of October 31, 2024, the company had roughly 9.5 million HSAs and \$30 billion in assets. The company’s competitive differentiation consists of its unique and purpose-built technology platform, integrated offering of HSAs with complementary CDBs, large and diverse distribution channel, and high level of customer service.

HealthEquity generates revenue from three sources: service fees, custodial revenue, and interchange. Service fees are paid by partners and clients for account administration services. Custodial revenue comes from interest earned on deposits placed with banks and insurance companies. The company earns interchange revenue from fees paid by merchants on payments that account holders make with a physical payment card to pay for medical expenses.

In addition to account growth and growth in assets, the yield on assets is a key growth driver for the business. Recently, the average annualized yield on assets has been increasing from unusually low levels (due to assets that were placed at exceptionally low interest rates during the COVID-19 years) and we expect this trend to continue as depositary contracts come up for renewal and assets are placed at today’s higher rates. In addition, the company has a program with insurance company partners called Enhanced Rates, which offers a higher interest rate to HealthEquity compared with the Basic Rates paid by federally insured bank partners. As contracts with Basic Rates mature, HealthEquity is placing an increasing percentage of assets into Enhanced Rates contracts. As a result, while short-term interest rates have been coming down, the company should see rising custodial rates over at least the next few years, which should boost custodial revenue, total company revenue, and cash flows. In addition, a new CEO is set to take over in January, and while we are big fans of the outgoing CEO Jon Kessler, we are optimistic that the new CEO Scott Cutler can find ways to create shareholder value. Finally, proposed legislation would expand the number of people eligible for HSAs (currently limited to people who have high deductible health plans), which if enacted would materially expand the company’s total addressable market.

We initiated a position in **Edgewise Therapeutics, Inc.**, which develops drugs that target muscle physiology, including sevasemten to treat Becker’s muscular dystrophy (BMD) and Duchenne muscular dystrophy (DMD), and EDG-7500 to treat hypertrophic cardiomyopathy (HCM). Sevasemten is a myosin inhibitor that is designed to protect fast-twitch muscle against contraction-induced injury in muscular dystrophy patients. Sevasemten recently showed impressive Phase 2 data in Becker’s patients that suggests a meaningful benefit in muscle function that will likely translate into Phase 3 success. There are no medicines approved specifically for Becker’s patients today, and we think this could be a \$1 billion drug. We think the drug should also work in Duchenne’s muscular dystrophy, since Duchenne’s is driven by the same underlying dysfunction in dystrophin protein as Becker’s. Edgewise is also developing EDG-7500, which targets cardiac sarcomere to treat hypertrophic cardiomyopathy. Although it’s early in development, EDG-7500 has shown early data that suggested impressive efficacy on LVOT gradient reduction without meaningful safety risks in the form of changes in ejection fraction. If this is borne out in more clinical trials, this would be an important point of differentiation versus existing treatments for HCM, which require patient monitoring and dose titration to avoid safety risks.

We added to the position in **Insmmed Incorporated**, a biopharmaceutical company with three lead drugs that we believe could collectively generate over \$8 billion of peak sales. The company expects to launch Brensocatib for non-cystic fibrosis bronchiectasis (NCFBE) in 2025. In a Phase 3 clinical trial, the drug achieved a 20% reduction in pulmonary exacerbations and an improvement in lung function. We think there could be as many as 500,000 NCFBE patients in the U.S. and that the disease is widely underdiagnosed (or rather, mis-diagnosed as asthma/COPD) given there are no approved treatments. In addition, brensocatib is a pipeline in a product. It’s a DPP1 inhibitor that is very potent against neutrophil serine proteases. Neutrophil serine protease activity is key in the cycle of inflammation and lung damage in bronchiectasis and is also known to play an important role in chronic rhinosinusitis without nasal polyps. In addition, another drug, Arikayce is on-market to treat refractory MAC lung disease and will likely get a front-line label with Phase 3 data expected in 2025. A third drug candidate, TP1P, is in the early stage but shows impressive efficacy/safety in PAH/PH-ILD and could be a best-in-class option.

We initiated a position in **Wave Life Sciences Ltd.**, which develops RNA-based drugs to treat a variety of conditions. Wave’s platform is based on their decade-plus research into stereochemistry and their novel phosphoryl guanidine (PN) oligonucleotide backbone, which enables them to develop RNA-based drugs that are more stable and better at getting into the target cell. We are most excited about Wave’s exon-skipping drugs to treat Duchenne Muscular Dystrophy (DMD), their INHBE RNAi obesity drug, and their new RNA-editing platform. Although DMD has become a competitive space, we think Wave has the most potent exon-skipping platform with WVE-N531 recently demonstrating 9.0% muscle-adjusted and 5.5% unadjusted dystrophin expression after 24 weeks. We think this supports approval in exon 53-skipping-amenable patients and also suggests that Wave’s other DMD exon-skipping drugs in earlier stages of development will have similarly potent results. In 2025, we are also expecting first clinical data for WVE-007, Wave’s INHBE RNAi drug for obesity and other metabolic disorders. As evidenced by the GLP-1 drug class, this is a huge potential market and the preclinical data for INHBE suggests this is an orthogonal mechanism that could drive impressive results as a twice-yearly injection. We are also excited about Wave’s new RNA-editing platform, which recently demonstrated impressive results in Alpha-1-antitrypsin deficiency (A1AT). Although the A1AT drug is



outlicensed to GlaxoSmithKline, we think this platform offers an elegant, convenient, and safe way to treat genetic diseases and has a wide range of applications.

We added to the position in **Arcellx, Inc.**, a biotechnology company dedicated to developing cell therapies for multiple myeloma. Data presented at a recent medical conference showed that the company's cell therapy is roughly as effective as the leading competitor cell therapy but without the risks of delayed neurotoxicity symptoms. In addition, through the company's partnership with Gilead, the global leader in cell therapy, Arcellx may have a manufacturing advantage. We continue to think Arcellx is well positioned to capture a significant share of the \$12 billion market opportunity for cell therapy for multiple myeloma.

Table VII.  
Top net sales for the quarter ended December 31, 2024

	Net Amount Sold (\$ millions)
ICON Plc	6.0
Merck & Co., Inc.	5.4
Elevance Health, Inc.	5.0
HCA Healthcare, Inc.	3.7
Regeneron Pharmaceuticals, Inc.	3.7

We sold **ICON Plc** due to contract research organization industry challenges. We sold **Merck & Co., Inc.** due to slowing Gardasil growth and emerging competition for key drug Keytruda. We sold **Elevance Health, Inc.** due to negative estimate revisions caused by challenges in the company's Medicaid business. We reduced **HCA Healthcare, Inc.** because of potential health care policy headwinds (discussed further below). We took a tax loss in **Regeneron Pharmaceuticals, Inc.** due to sooner than expected generic competition for Eylea and slower than expected conversion from Eylea to Eylea HD.

OUTLOOK

Health care stocks underperformed the broader market for the second year in a row. Heading into the presidential election, certain health care sub-industries experienced negative earnings revisions. Elevated medical cost trends and insufficient rate increases hit the earnings of managed care stocks. Life sciences tools stocks faced continued cautious biopharmaceutical spending, customer inventory destocking, and weakness in China. Then, after the election, President-elect Trump's nomination of Robert F. Kennedy Jr. as Secretary of Health and Human Services sparked investor fears about disruptive health care policies, leading to a sharp decline in health care stocks in the last two months of 2024. Proposed legislation at year end, which included PBM reforms (such as delinking drug prices from PBM compensation in Medicare Part D, banning spread pricing in Medicaid, and requiring PBMs to divest any pharmacies they own) exacerbated investor concerns.

We think market sentiment towards health care stocks is at maximum negativity and the sector is poised for better performance as the overhang from policy uncertainty fades and fundamentals improve. Valuations for many stocks in the sector are at multi-year lows relative to the S&P 500 Index.

Business trends for medical device companies like **Intuitive Surgical, Inc.**, **Boston Scientific Corporation**, and **Stryker Corporation** remain strong,

driven by new product cycles and healthy procedure volumes. We think these companies face lower risks related to potential health care policy changes.

We continue to see opportunities in the biotechnology sector outside of mega-cap companies. We remain bullish on **argenx SE**, **Arcellx, Inc.**, and **Insmmed Incorporated**, among others, and we added new biotechnology names with innovative drugs in their pipelines. We also think with the new Republican administration and new leadership at the FTC that M&A activity could accelerate as large pharmaceutical companies look to replenish their pipelines as key products lose patent protection.

On the topic of drug pricing, we see risk the Trump administration could utilize the IRA Medicare drug pricing negotiation program to narrow the price differential between drug prices in the U.S. and in Europe. This was a goal during the first Trump administration and now there is a mechanism to implement it. We remain substantially underweight mega-cap pharmaceutical and biotechnology, despite low valuations, because many of these companies face patent cliffs and pricing pressure. The next list of 15 drugs selected for price negotiation will be published by February 1, 2025 (the prices will be disclosed in November 2025 but not implemented until 2027). On the positive side for the industry, it is possible that Congress could amend the IRA to extend the period in which small molecules are exempt from Medicare price negotiation to match biologics – the law now gives small molecules just 9 years post-FDA approval before they are subject to price negotiation, while biologics have 13 years.

We continue to look for a recovery in the life sciences tools sector. After two years of nominal growth, we expect growth to accelerate. Customer inventory destocking is largely over, biotechnology funding has improved (up around 40% in 2024), innovation in the biotechnology sub-industry continues to advance, and demand in China has stabilized. While new concerns have arisen regarding the NIH budget, tariffs, and foreign currency headwinds, we think the long-term outlook is positive for our life sciences tools holdings which serve attractive end markets with favorable long-term trends.

The outlook for managed care companies is mixed. In the near term, managed care companies face elevated cost trends and insufficient rate increases in the Medicare Advantage business, a mismatch between rates and acuity in the Medicaid business, and potential policy changes, such as PBM reforms. **UnitedHealth Group Incorporated** also faces a government investigation threatening to break up the company and has been the target of relentless media attacks on its market power and business practices.

Long term, we believe managed care companies will remain embedded in the U.S. health care system and will continue to grow. Encouragingly, CMS just proposed a rate increase for Medicare Advantage companies for 2026 that was higher than investor expectations, which should drive better margins and profits in 2026. Regarding potential PBM reform, if legislation bans spread pricing and/or requires PBMs to pass through 100% of rebates to prescription drug plan sponsors, by contract the payment to the PBMs would change to a fee-based model, which would minimize the economic impact. Proposed legislation requiring PBMs to divest pharmacies seems less likely to pass. Regarding the risk of a government break-up of UnitedHealth or possible new regulations relating to utilization management practices, we think these are relatively low risks. UnitedHealth management has guided to high single-digit earnings growth in 2025. Beyond 2025, earnings growth should accelerate as medical cost trends normalize and as rates improve under the new Republican administration which may adopt a more industry friendly stance. At year end, the stock was trading at close to a 10-year low valuation relative to the S&P 500 Index.

# Baron Health Care Fund

Health care policy uncertainty has been a factor weighing on hospital stocks. Enhanced ACA subsidies are set to expire at the end of 2025. If Congress does not renew the enhanced ACA subsidies, an estimated four million people would become uninsured, which would negatively impact the earnings of the hospital companies that serve those people. In addition, potential Medicaid reform is another risk for hospitals which have benefited from state-directed payments/supplemental payments over the past few years. As a result of these risks, we reduced our hospital positions.

Last quarter, we highlighted how a team of researchers in China reversed a woman's diabetes through a stem cell transplant using her own cells which they had reprogrammed. In that case, the patient was taking immunosuppressants. The scientific advance we are highlighting this quarter is the news from Sana Biotechnology, which reported data in early January from a first in human study in Sweden. In the study, a patient with type 1 diabetes received an implant of islet cells taken from a deceased donor and edited by Sana so that the cells would not be recognized and rejected by the patient's immune system. After four weeks, the implanted cells are alive and producing insulin without the need for immunosuppression. The key breakthrough is that the cells evaded the patient's immune system without the patient having to take immunosuppressants. While the data is from only one patient and there is a long way to go before there is a viable, commercially available product, this news marks an important step towards a potential cure for type 1 diabetes.

Overall, despite near-term policy uncertainty, we think fundamentals are stabilizing, and our long-term outlook for Health Care remains bullish. Innovation in the sector is robust. Advances in science and technology are leading to new ways to diagnose, monitor, and treat diseases in more cost-effective ways. Favorable demographic trends should drive increased demand for quality health care. We continue to follow our process for identifying investment opportunities and creating a portfolio of competitively advantaged growth companies with strong management teams.

Thank you for investing in the Fund. I remain an investor in the Fund, alongside you.

Sincerely,



Neal Kaufman  
Portfolio Manager

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*Investors should consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The prospectus and summary prospectus contains 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 [BaronCapitalGroup.com](http://BaronCapitalGroup.com). Please read them carefully before investing.*

**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 Fund may not achieve its objectives. Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

The discussions of the companies herein are not intended as advice to any person regarding the advisability of investing in any particular security. The views expressed in this report reflect those of the respective portfolio manager only through the end of the period stated in this report. The portfolio manager's views are not intended as recommendations or investment advice to any person reading this report and are subject to change at any time based on market and other conditions and Baron has no obligation to update them.

This report does not constitute an offer to sell or a solicitation of any offer to buy securities of Baron Health Care Fund by anyone in any jurisdiction where it would be unlawful under the laws of that jurisdiction to make such offer or solicitation.

**EPS Growth Rate** (3-5-year forecast) indicates the long term forecasted EPS growth of the companies in the portfolio, calculated using the weighted average of the available 3-to-5 year forecasted growth rates for each of the stocks in the portfolio provided by FactSet Estimates. The EPS Growth rate does not forecast the Fund's performance.

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