

## Baron Fifth Avenue Growth Fund

# Finding Growth Opportunities in Large Cap Stocks

In late 2011, Alex Umansky joined Baron to take over management of the Baron Fifth Avenue Growth Fund. We are pleased to report that since then, the Fund has significantly outperformed its benchmarks. We thought it would be a good time to provide an update on the portfolio, our strategy, and our outlook for Large Cap stocks.

### Performance\* vs. benchmark as of 3/31/14

Performance	Baron 5 <sup>th</sup> Avenue Growth Fund	S&P 500 Index	Russell 1000 Growth Index
<b>Annualized since inception**</b>	7.03%	7.65%	8.06%
<b>Annualized since 12/31/11***</b>	24.62%	21.97%	21.70%
<b>One-year</b>	29.56%	21.86%	23.22%

\* Retail shares

\*\* 4/30/04

\*\*\* Alex Umansky took over management of the Fund in late 2011



Alex Umansky  
Portfolio Manager

**Q.** *You made a lot of changes after you took over the Baron Fifth Avenue Growth Fund and the early results are encouraging with the strategy outperforming its benchmarks by more than 15% over your first two full years (2012 & 2013). What are you doing differently?*

**A.** Our portfolio has 30 to 40 stocks, to avoid over-diversification. There is no doubt in my mind that over-diversification has diminished active returns in the Large Cap equity category. The companies have been around for many years, are widely followed by analysts, and are typically very transparent. This is clearly the most efficient asset category. Having a portfolio of 80 or over 100 stocks

in an effort to mitigate volatility makes no sense to me. As a long term investor or an owner of the business why should I care about daily or monthly stock price fluctuations? If you do care, you need to over-diversify to dampen the volatility effect but you will inevitably give up opportunities to generate alpha.

Another difference is in trading and portfolio turnover. I see no point in turning over 100% of a Large Cap portfolio, which is average for this category. If we can find four or five new ideas per year, that's a good/fertile year for us. The turnover in our Fund was always below average, but we reduced it even more and cut down on trading around positions.

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*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. Current performance may be lower or higher than the performance data quoted above. For performance information for the most recent month end, visit [www.BaronFunds.com](http://www.BaronFunds.com) or call 1-800-99Baron. The Adviser has reimbursed certain Fund expenses for the Fund, and Funds' transfer agency expenses may be reduced by expense offsets from an unaffiliated transfer agent, without which performance would have been lower. As of 9/30/2013, the expenses of the Fund were 1.47% total and 1.30% net (net of the Adviser's fee waivers).*

**Alpha:** measures the difference between a fund's actual returns and its expected performance, given its level of risk as measured by beta. **Beta:** measures a fund's sensitivity to market movements. The beta of the market (S&P 500 Index) is 1.00 by definition.

The indexes are unmanaged. The **S&P 500 Index** measures the performance of 500 widely held large-cap U.S. companies. The **Russell 1000® Growth Index** measures the performance of large-sized U.S. companies that are classified as growth. The indexes and the Fund are with dividends, which positively impact the performance results.

In a world of instant and abundant information, the ability to think independently and creatively often leads to unique insights and perspectives.

Our turnover in 2013 was 17%, which is probably about right.

**Q.** *So what does a Baron Large Cap company look like? What are you looking for in your investments?*

**A.** As a firm, we look for unique companies with sustainable competitive advantages that we believe have the ability to reinvest capital at high rates of return. Management with a proven track record of value creation and long-term ownership mindset is also important.

In this portfolio we focus on platform companies that benefit from economies of scale and the network effect, which in turn frequently lead to massive barriers to entry and long tails. Platform companies are those that have built a platform that others can easily connect their businesses to, build products and services around, and co-create value. For example, Apple's App Store allows external developers to connect with Apple customers. Another platform company, Amazon, has shifted much of its

business from a distribution channel selling products to an engagement platform connecting third-party retailers with customers.

"Platform" has become a popular way for many businesses to describe themselves lately, especially in technology with the emergence of big data, cloud services, etc. We think few of these companies have earned the term. With true platform companies – such as Amazon.com, Google or Facebook – most of the users, merchants and advertisers want to do business with them, which in time should lead to better monetization opportunities. Outside of tech, companies like CME Group, Monsanto, Starbucks, and Brookfield Asset Management are rarely if ever thought of as platform businesses, but in our view, it is exactly what they are.

We try to invest in high quality business models, and we always look at the business as an owner. To us, high quality means the ability to grow revenues organically, with pricing power, over long periods of time. Cash flows and returns on invested capital (ROIC) are critical. We like businesses that throw off a lot of cash and do not have high maintenance capital expenditures, so low capital intensity is a plus. As a firm we try to invest in quality businesses because we believe over time quality always outperforms.

**Q.** *Some of the companies you invest in appear to trade at very high multiples. How do you look at the valuations of companies like Amazon.com or Facebook?*

**A.** Your time frame really matters. Valuations can seem irrational at times, but we know these are clearly good businesses. Since their IPOs, Google's ROIC on average has been in the 90s, Facebook's in the 70s, Priceline's in triple digits. If you're willing to be patient, and think about how big this company can be in five or 10 years, it quickly starts to make sense. We participated in Facebook's IPO at \$38 per share, initiating a 1% position in the Fund. As user engagement transitioned from desktop to mobile, the company's growth slowed down and the stock collapsed into the high teens. We

thought it was a unique company with real competitive advantages and viewed mobile monetization as a question of "when" rather than "if." Market participants' over-emphasis of short term results allowed us to build a real size position (greater than 4%) at an average cost of \$25½ per share. We thought it would take a while for the company and for the market to figure it out, but sometimes it happens a lot quicker than anyone might expect, which was the case with Facebook.

With Amazon and Facebook, as with all of our companies, we ask ourselves how big they can be at maturity. So Walmart, a retailer that isn't growing very much today (and which we don't own), has a market cap of \$250 billion. Amazon, the largest e-commerce player in the world today, has a market cap of \$150 billion. While Walmart's penetration is high and likely near saturation, e-commerce today is maybe 10% penetrated. We think that should enable the largest platform company in this space to continue to grow quite rapidly (over 20%) for years to come. Jeff Bezos' vision was always to create a Walmart online and he inadvertently ended up creating the e-commerce category and in the process changing the logistics business forever. It is apparent to us that the largest e-commerce provider will be orders of magnitude larger than the largest brick-and-mortar retailer today, so we think there is plenty of opportunity left for a patient investor.

**Q.** *What themes or sectors do you believe present attractive opportunities today?*

**A.** DNA sequencing is a big deal. DNA code is like a book. It can be written and re-written or partially written in any way desired by the author. Our largest position is in a company called Illumina. It is the dominant provider of tools and services for genetic analysis. Over 90% share of the world's sequencing output is produced on Illumina's instruments. Illumina is a great example of our process working well. The company was going through a classical product transition in the middle

of 2011 and missed a quarter and took guidance down. The timing happened to coincide with sequestration and a potential government shutdown. Roughly a third of Illumina's revenues are from academic research, which depends on funding from the National Institute of Health, which was coming under significant pressure. The stock went from \$78 to \$26 in less than 3 months. We thought what was going on had nothing to do with Illumina's dominant competitive advantages or the inevitable advancements and commercialization of the DNA testing market, which we believed could be quite large. As of this writing, the stock price is about \$150 and it has been our largest contributor the past two years. We believe Illumina is a platform company with a phenomenal business model and superb management team that will benefit from the network effect and domination in its category.

While we are bottom up investors, we are big believers in innovation. Think of the effect that an all-electric driverless car would have on the world. Driverless cars have already driven close to a million miles with much better/safer results. Every major car manufacturer is working on driverless cars. Google has a major investment in the technology of driverless cars, and has been test driving prototypes for its Google Earth project. The cool thing is I think this will be happening much faster than people think. My 17 year old is driving her mother crazy practicing for a road test, but my six year old has a good chance of NEVER needing a driver's license. The number and severity of auto

accidents will decline dramatically. A recent report by Morgan Stanley on autonomous cars estimated cost savings to exceed \$1.3 trillion. That's a pretty big dislocation that presents some pretty big opportunities.

**Q.** *The market had two years of very strong returns and many investors feel that they may have missed the rally. Is this still a good time to invest? Do you believe the U.S. economy is on solid footing?*

**A.** Most of the returns in the U.S. and elsewhere over the last two years resulted from multiple expansions rather than earnings growth, which is consistent with early stages of a recovery. However, we believe the multiples are still reasonable as long as we get the earnings growth that we expect, and we think we will. We believe the Federal Reserve's decision to taper its program of Quantitative Easing (the purchase of government and mortgage bonds) is a good thing. However, whichever way it is done, living through some volatility is unavoidable. But there is also a lot of positive optionality for the market today. Healthcare reform, tax reform, immigration reform – if Congress could get even one of these things right, it could really reinvigorate economic growth.

**Q.** *Finally, what skillsets or traits do you believe are most important for success in investing?*

**A.** Passion, lateral thinking, and creativity. Passion is obvious. Everyone is passionate about something. The idea is not to stimulate passion but to discover what makes us passionate. People at Baron are

With Amazon and Facebook, as with all of our companies, we ask ourselves how big they can be at maturity.

passionate about investing. Lateral thinking is looking for the drivers of change, figuring out if change is real and sustainable, and having the ability to identify implications and fallouts. Creativity is the hardest and rarest trait of all. In a world of instant and abundant information, the ability to think independently and creatively often leads to unique insights and perspectives. In my view, that's the real competitive advantage in our business. ■

*The Fund invests primarily in equity securities, which are subject to price fluctuations in the stock market. 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.*

## Investing with Baron

### Retirement Planning: Invest in an IRA Now

Now is a great time to consider your investment plans for this year. You have until April 15, 2014 to invest in a traditional or Roth IRA for the 2013 tax year. You can also make contributions for 2014. If you'd like to roll over an existing IRA into the Baron Funds, please call **800-99-BARON** for assistance or open an account online at [www.BaronFunds.com/openaccount](http://www.BaronFunds.com/openaccount). Baron waives account fees for balances over \$10,000.

Performance as of March 31, 2014

RETAIL SHARES									
		Average Annualized Returns			Since Inception		Inception Date	Expense Ratio	Ticker
		1-Year	5-Year	10-Year	Annualized	Cumulative			
Small Cap	Baron Growth Fund	22.23%	24.04%	9.77%	14.03%	1152.28%	12/31/94	1.30% <sup>1</sup>	BGRFX
	Baron Small Cap Fund	21.18%	23.43%	9.32%	10.40%	411.70%	9/30/97	1.31% <sup>1</sup>	BSCFX
	Baron Discovery Fund	N/A	N/A	N/A	N/A	27.10%	9/30/13	3.25%/1.35% <sup>2</sup>	BDFFX
Smid Cap	Baron Focused Growth Fund <sup>3</sup>	12.82%	20.84%	11.45%	11.84%	635.99%	5/31/96	1.48%/1.35% <sup>4</sup>	BFGFX
Mid Cap	Baron Asset Fund	22.34%	22.79%	9.51%	11.56%	1777.22%	6/12/87	1.32% <sup>1</sup>	BARAX
	Baron Opportunity Fund	25.29%	23.69%	10.09%	5.44%	110.97%	2/29/00	1.37% <sup>1</sup>	BIOPX
Large Cap	Baron 5 <sup>th</sup> Ave. Growth Fund	29.56%	20.55%	N/A	7.03%	96.08%	4/30/04	1.47%/1.30% <sup>1</sup>	BFTHX
All Cap	Baron Partners Fund <sup>3</sup>	31.11%	26.52%	11.61%	13.45%	1541.30%	1/31/92	1.40%/0.34% <sup>4</sup>	BPTRX
	Baron Emerging Markets Fund	14.09%	N/A	N/A	5.45%	18.83%	12/31/10	4.01%/1.50% <sup>4</sup>	BEXFX
Int'l	Baron Global Advantage Fund	28.53%	N/A	N/A	17.63%	36.50%	4/30/12	8.35%/1.50% <sup>4</sup>	BGAFX
	Baron Int'l Growth Fund	21.44%	18.52%	N/A	16.07%	118.68%	12/31/08	1.78%/1.50% <sup>4</sup>	BIGFX
Specialty	Baron Energy and Rsrcs Fund	19.47%	N/A	N/A	10.88%	26.16%	12/30/11	9.07%/1.35% <sup>4</sup>	BENFX
	Baron Real Estate Fund	17.82%	N/A	N/A	23.15%	142.26%	12/31/09	1.76%/1.35% <sup>4</sup>	BREFX

INSTITUTIONAL SHARES									
		Average Annualized Returns			Since Inception		Inception Date	Expense Ratio	Ticker
		1-Year	5-Year	10-Year	Annualized	Cumulative			
Small Cap	Baron Growth Fund	22.56%	24.36%	9.91%	14.11%	1168.08%	12/31/94	1.05% <sup>1</sup>	BGRIX
	Baron Small Cap Fund	21.47%	23.73%	9.45%	10.48%	417.95%	9/30/97	1.05% <sup>1</sup>	BSFIX
	Baron Discovery Fund	N/A	N/A	N/A	N/A	27.30%	9/30/13	3.00%/1.10% <sup>2</sup>	BDFIX
Smid Cap	Baron Focused Growth Fund <sup>3</sup>	13.10%	21.11%	11.57%	11.91%	644.22%	5/31/96	1.16%/1.10% <sup>4</sup>	BFGIX
Mid Cap	Baron Asset Fund	22.66%	23.11%	9.65%	11.62%	1801.34%	6/12/87	1.05% <sup>1</sup>	BARIX
	Baron Opportunity Fund	25.56%	24.01%	10.23%	5.54%	113.71%	2/29/00	1.11% <sup>1</sup>	BIOIX
Large Cap	Baron 5 <sup>th</sup> Ave. Growth Fund	29.93%	20.85%	N/A	7.16%	98.51%	4/30/04	1.18%/1.05% <sup>1</sup>	BFTIX
All Cap	Baron Partners Fund <sup>3</sup>	31.46%	26.84%	11.76%	13.52%	1562.34%	1/31/92	1.13%/0.35% <sup>4</sup>	BPTIX
	Baron Emerging Markets Fund	14.49%	N/A	N/A	5.71%	19.78%	12/31/10	3.37%/1.25% <sup>4</sup>	BEXIX
Int'l	Baron Global Advantage Fund	28.95%	N/A	N/A	17.94%	37.20%	4/30/12	7.33%/1.25% <sup>4</sup>	BGAIX
	Baron Int'l Growth Fund	21.85%	18.83%	N/A	16.36%	121.53%	12/31/08	1.40%/1.25% <sup>4</sup>	BINIX
Specialty	Baron Energy and Rsrcs Fund	19.64%	N/A	N/A	11.09%	26.70%	12/30/11	8.65%/1.10% <sup>4</sup>	BENIX
	Baron Real Estate Fund	18.12%	N/A	N/A	23.44%	144.71%	12/31/09	1.44%/1.10% <sup>4</sup>	BREIX

Baron Growth Fund, Small Cap Fund and Discovery Fund invest primarily in small-cap securities, Baron Asset Fund in mid-cap securities, Baron Focused Growth Fund and International Growth Fund in both. Small and mid-cap securities may be thinly traded and more difficult to sell during market downturns. Baron Opportunity Fund emphasizes mid-sized companies that we believe will benefit from innovations and advances in technology, which present the risk of rapid change and product obsolescence and their successes may be difficult to predict for the long term. Baron Partners Fund, Focused Growth Fund, Baron Real Estate Fund and Baron Energy and Resources Fund are non-diversified and Baron Partners Fund uses leverage, which increase volatility of the Funds' returns and expose the Funds to greater loss in any given period. In addition, the value of Baron Real Estate Fund is affected by the strength of the real estate markets. Baron Fifth Avenue Growth Fund invests primarily in large-cap securities, which like all equities are subject to price fluctuations in the stock market. Baron International Growth Fund, Baron Emerging Markets Fund and Baron Global Advantage Fund invests primarily in non-U.S. securities, which involve additional risks to those inherent in U.S. investments, including exchange-rate fluctuations, political or economic instability, the imposition of exchange controls, expropriation, limited disclosure and illiquid markets. These risks are heightened for the Baron Emerging Markets Fund. Baron Energy and Resources Fund invests in energy companies, which can be affected by fluctuations in energy prices and supply and demand of energy fuels, and in resources industries, which can be affected by international political and economic developments, the success of exploration projects, and meteorological events.

<sup>1</sup> As of September 30, 2013 for Baron Asset, Baron Growth, Baron Small Cap, Baron Opportunity and Baron Fifth Avenue Growth Funds. For Baron Fifth Avenue Growth Fund, the total expense ratio was 1.47% for the Retail share class and 1.18% for the Institutional share class, but the net annual expense ratio is 1.30% for the Retail share class and 1.05% for the Institutional share class (net of the Adviser's fee waivers).

<sup>2</sup> For Baron Discovery Fund, the estimated total expense ratio is 3.25% for the Retail share class and 3.00% for the Institutional share class, but the estimated net annual expense ratio is 1.35% for the Retail share class and 1.10% for the Institutional share class (net of the Adviser's fee waivers).

<sup>3</sup> Reflects the actual fees and expenses that were charged when the Funds were partnerships. The predecessor partnerships charged a 20% performance fee (Baron Partners Fund) or a 15% performance fee (Baron Focused Growth Fund) after reaching a certain performance benchmark. If the annual returns for the Funds did not reflect the performance fee for the years the predecessor partnerships charged a performance fee, returns would be higher. The Funds' shareholders are not charged a performance fee. The predecessor partnerships' performance is only for periods before the Funds' registration statements were effective (4/30/03 for BPF and 6/30/08 for BFGF). During those periods, the predecessor partnerships were not registered under the Investment Company Act of 1940 and were not subject to its requirements or the requirements of the Internal Revenue Code relating to registered investment companies, which, if they were, might have adversely affected their performance.

<sup>4</sup> As of December 31, 2012 for Baron Partners, Baron Focused Growth, Baron International Growth, Baron Real Estate, Baron Emerging Markets, Baron Energy and Resources and Baron Global Advantage Funds. Total expense ratio shown for Baron Partners Fund was comprised of operating expenses of 1.40% and interest expense of 0.34% for the Retail share class and 1.13% and 0.35%, respectively, for the Institutional share class. For Baron Focused Growth Fund, the total expense ratio was 1.48%, but the net annual expense ratio was 1.35% for the Retail share class and 1.16% and 1.10%, respectively, for the Institutional share class (net of the Adviser's fee waivers). For Baron International Growth Fund, the total expense ratio was 1.78%, but the net annual expense ratio was 1.50% for the Retail share class and 1.40% and 1.25%, respectively, for the Institutional share class (net of the Adviser's fee waivers). For Baron Real Estate Fund, the total expense ratio was 1.76% but the net annual expense ratio was 1.35% for the Retail share class and 1.44% and 1.10%, respectively, for the Institutional share class (net of the Adviser's fee waivers). For Baron Emerging Markets Fund, the total expense ratio was 4.01%, but the net annual expense ratio was 1.50% for the Retail share class and 3.37% and 1.25%, respectively, for the Institutional share class (net of the Adviser's fee waivers). For Baron Energy and Resources Fund, the total expense ratio was 9.07%, but the net annual expense ratio was 1.35% for the Retail share class and 8.65% and 1.10%, respectively, for the Institutional share class (net of the Adviser's fee waivers). For Baron Global Advantage Fund, the total expense was 8.35%, but the net annual expense ratio was 1.50% for the Retail share class and 7.33% and 1.25%, respectively, for the Institutional share class (net of the Adviser's fee waivers).

Portfolio holdings as a percentage of net assets as of March 31, 2014 for securities mentioned are as follows: Apple, Inc. - 4.2%, Amazon.com, Inc. - 4.8%, Google, Inc. - 5.5%, Facebook Inc. - 1.9%, CME Group, Inc. - 3.0%, Monsanto Co. - 4.3%, Starbucks Corp. - 3.7%, Brookfield Asset Management, Inc. - 2.6%, priceline.com, Inc. - 4.3%, Illumina, Inc. - 6.2%.

The Adviser has reimbursed certain Fund expenses for Baron Opportunity Fund, Baron Fifth Avenue Growth Fund, Baron Focused Growth Fund, Baron International Growth Fund, Baron Real Estate Fund, Baron Emerging Markets Fund, Baron Energy and Resources Fund, Baron Global Advantage Fund and Baron Discovery Fund (by contract as long as BAMCO, Inc. is the adviser to the Funds).

You should consider the investment objectives, risks, charges, and expenses of the Fund carefully before investing. The prospectus and summary prospectus contain this and other information about the Fund and can be obtained from the Fund's distributor, Baron Capital, Inc., by calling 1-800-99BARON or visiting www.BaronFunds.com. Please read them carefully before investing.

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