

## Congratulations to the Baron Emerging Markets Fund on its Three Year Anniversary Finding Growth Opportunities Overseas



Michael Kass,  
Portfolio Manager

Three years ago, we launched the Baron Emerging Markets Fund with Michael Kass as Portfolio Manager, with the objective of applying our research-intensive, long-term investment approach to companies in the developing world. We are pleased to report that the Fund has significantly outperformed its benchmark on an annualized basis, both since inception and over the last year, and as of 12/31/13, based on total returns, is ranked in the third percentile among its Morningstar peers, at below average risk. Morningstar awarded the Fund its highest 5-star rating for the Fund's full three-year performance and risk profile ended 12/31/13.

### Performance\* vs. benchmark as of 12/31/13

Performance	Baron Emerging Markets Fund	MSCI EM IMI Growth Index
<b>Annualized since inception**</b>	5.32	-1.14
<b>One-year</b>	14.71	0.10

\*retail shares      \*\*12/31/10

The Fund recently passed the three-year mark, and we thought it would be an ideal time to provide an update on the portfolio, our strategy, and the emerging markets.

### EM Companies with a Baron Flavor

Investing in emerging markets may seem like a formidable undertaking. With thousands of companies operating across a variety of countries and regions to choose from, where do we begin? Moreover, how does the evolving matrix of political, economic, regulatory and cultural factors at the local, national and global levels play into our investment decisions? Baron finds opportunities in emerging markets

through a differentiated strategy that combines fundamental, bottom-up research with compelling investable themes. Our in-depth, integrated approach allows us to navigate the emerging markets investment landscape and uncover opportunities that we believe have a high likelihood of attractive growth and value creation.

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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 12/31/2012, the expenses of the Fund were 4.01% total and 1.50% net (net of the Adviser's fee waivers).*

As of 12/31/13, there were 614 and 399 funds, respectively, for the 1-year and three-year periods in the Morningstar US OE Diversified Emerging Mkts category. Morningstar 3 year star rating is based on risk adjusted returns. For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a fund's monthly performance (including the effects of sales charges, loads, and redemption fees), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each 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. (Each share class is counted as a fraction of one fund within this scale and rated separately, which may cause slight variations in the distribution percentages.)

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According to Morningstar, the Fund's upside capture ratio was 94.03 and downside capture ratio was 68.98 since inception. Upside capture explains how well a fund performs when the benchmark's returns are greater than zero and downside capture explains how well a fund performs when the benchmark's returns are less than zero.

# Themes allow us to narrow down our universe of stocks and identify promising investment opportunities.

## Investable Themes

Our strategy for the Emerging Markets Fund often starts with identifying defined, long-term investment themes which, in turn, helps us identify long term, sustainable growth opportunities. A theme is a fundamental change that we believe will drive predictable demand and/or rising profitability over a long period of time, increasing the likelihood of higher earnings growth and return on capital for related companies. Investment themes can be driven by developments such as regulatory, political or technological changes; vertical integration in an industry; or changes in the financial or economic environment. They may be industry-specific, country-specific, regional or global in scope. Themes allow us to narrow down our universe of stocks while also focusing our research process and concentrating our invested capital on promising investment opportunities.

## Bottom-up Research

While themes may serve to focus our resources, ultimately, we add value through fundamental, bottom-up stock selection. We look for entrepreneurial companies that fit the Baron investment criteria and that we believe are best positioned to take advantage of an opportunity. We develop and confirm an investment thesis for the company, and validate key criteria by performing due diligence, including meeting

with management; consulting with industry experts; speaking with local contacts in key markets such as vendors, suppliers and competitors; and reviewing the company's track record and public filings. We verify our thesis through analysis of past performance and external checks with business partners, current and/or former employees, and industry participants. If we then decide to add a company to the portfolio, we maintain ongoing conviction through qualitative and quantitative analysis and continued monitoring of key variables.

In every company in which we invest, we look for key Baron investment criteria, such as (1) a significant opportunity for growth, (2) sustainable competitive advantages, (3) strong, visionary management, and (4) risk-adjusted return potential over a four to five year horizon. Within the emerging markets, we emphasize the following three attributes, given the particular nuances of these markets:

### Entrepreneurial management

- Founders with significant ownership stakes
- Strategic vision and financial sophistication

### Capital efficiency

- High return on invested capital
- Asset-light business models
- Private, non-government controlled companies

### Shareholder-friendly governance

- Alignment of interests between management and minority shareholders
- Independent directors
- Minimal related party transactions and/or conflicts of interest

We believe these attributes, which serve to align our interests as minority shareholders with those who control and manage the business, are critical to successful investing in emerging markets. Further, we believe

that our disciplined approach in emphasizing these attributes, which we believe represent scarcity value in these markets, differentiates us from a broad index and many other emerging market strategies.

Below are three examples of our integrated thematic and bottom-up investment approach.

## Economic and financial reform in China

After months of anticipation, in November, China's new leadership revealed plans to implement sweeping economic, financial and social reforms in a bid to de-emphasize capital-intensive investments while stimulating and supporting domestic consumption and expansion of the Chinese middle class. Highlights of the 60-point plan include liberalization of interest and deposit rates, relaxation of the one-child policy, and reforms to benefit migrant workers settling in urban areas. We believe the reforms could substantially improve the country's longer-term investment potential – even if causing some short-term pain. In recent years, China has suffered a noticeable decline in capital productivity as a result of the near monopoly on credit issuance by state-controlled, politically motivated bank bureaucrats. The reforms are aimed at transitioning China to a more market-driven and credit sensitive system, while reducing inefficiency and corruption.

Securities firms such as **Haitong Securities Co., Ltd.** are poised to gain a substantial share of the country's credit issuance from the traditional bank sector via the equity, corporate bond, and asset securitization markets. We believe Haitong is the highest quality pure play company to participate and is well positioned to benefit from financial reform. Financial reform should also improve capital access for many productive small and medium-sized businesses, since credit issuance will be based increasingly on financial merit, rather than political connections.

We have also identified companies in Consumer Discretionary and other sectors

in China that we think are both directly and indirectly positioned for strong reform-driven growth. One example: **Biostime International Holdings Ltd.**, a premium pediatric nutrition and baby care products provider that stands to gain from the loosening of China's one-child policy. The company has excellent brand recognition, superior distribution and customer relationship management protocols and strong corporate governance measures. Another example is **Sihuan Pharmaceutical Holdings Group Ltd.**, China's third biggest research-driven pharmaceutical company, which we think should benefit from increasing government investment in a stronger social safety net, of which healthcare is a major focus. Sihuan is a leader in cardiovascular disease treatments and is building a pipeline of innovative drugs.

Since we look to invest in what we believe are capital efficient and entrepreneurial private-sector companies, we believe reform will benefit our current holdings as well as provide ongoing opportunity for our investors going forward.

## Digitization in India's cable & media sector

The Telecom Regulatory Authority of India recently mandated the conversion of analog to digital cable services through the deployment of set-top boxes in households throughout India, in order to capture more tax revenue and lay the groundwork for improved broadband Internet access. We think this move will result in a significant increase in profitability for India's major cable distribution and programming providers that can make the significant capital investment required to execute on this digitization strategy. Until recently, local cable operators, which the major cable providers depend on for last mile infrastructure and collec-

tion of revenues, officially disclosed only an estimated 15% of total subscribers. With mandatory digitization, however, it will be virtually impossible to underreport customers. As a result, we anticipate that subscription revenues for the major providers could increase by up to 400-500% over a three-to-five-year period, although profit growth, at least initially, will be more modest due to the high level of capital investment involved. Consolidation as a result of companies struggling to secure the funding needed to deploy the set-top boxes also should serve to boost growth among our holdings.

To capitalize on this theme, we have invested in several major Indian cable and media programming companies, including **DEN Networks Ltd.**, **Dish TV India Ltd.**, **Zee Entertainment Enterprises, Ltd.**, and **Sun TV Network Ltd.** All have the strong balance sheets that will allow them to access the capital needed to purchase and deploy the set-top boxes and invest in new digital programming and content. They also exhibit the bottom-up attributes that we look for, including visionary, entrepreneurial management teams and a strong and growing market share.

## Brazilian post-secondary education reform

Brazil's post-secondary education enrollment rate is among the lowest in Latin America. In a bid to educate its citizenry and double enrollment rates to 50% by 2020, the Brazilian government has launched a new student loan program called FIES. In turn, FIES is creating market opportunities for quality education providers. Our largest holding in this attractive sector, **Kroton Educacional SA**, has the largest exposure to FIES, with nearly 50% of its students on the program. The FIES program has helped drive enrollment growth at Kroton, which

excels at assisting students in navigating the complex loan application process. FIES students also pay higher average tuition, and have lower dropout rates and fewer delinquent accounts than non-FIES students. Kroton has also shown exceptional proficiency at filling classrooms, leveraging economies of scale, and taking advantage of ongoing consolidation in the industry, all of which are contributing to growth and profit margin expansion.

## Looking Abroad, Looking Ahead

Although the emerging markets present many challenges, they also offer the potential of superior growth and dynamic change. Over the next decade, developing economies, in all likelihood, will remain the key drivers of global growth, driven largely by the rapidly expanding middle class in these countries. We seek to apply the Baron investment discipline to investing in this attractive asset class. We think that the companies that comprise our emerging markets portfolio, unique in their innovative, entrepreneurial management teams, capital efficiency, and share-holder-friendly governance, offer a long-term likelihood of growth and significant value creation for our investors. ■

*In addition to the general stock market risk that securities may fluctuate in value, investments in developing countries may have increased risks due to a greater possibility of: settlement delays; currency and capital controls; interest rate sensitivity; corruption and crime; exchange rate volatility; and inflation or deflation. The Fund invests in companies of all sizes, including small and medium sized companies whose securities may be thinly traded and more difficult to sell during market downturns.*

# 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 2013. 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 December 31, 2013<sup>1</sup>

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	38.32%	22.10%	10.52%	14.22%	1149.86%	12/31/94	1.32% <sup>1</sup>	BGRFX
	Baron Small Cap Fund	37.77%	21.72%	10.19%	10.64%	416.75%	9/30/97	1.31% <sup>1</sup>	BSCFX
Smid Cap	Baron Focused Growth Fund <sup>3</sup>	25.69%	19.19%	12.88%	12.05%	639.17%	5/31/96	1.48%/1.35% <sup>2</sup>	BFGFX
Mid Cap	Baron Asset Fund	38.88%	19.95%	10.26%	11.65%	1766.10%	6/12/87	1.33% <sup>1</sup>	BARAX
	Baron Opportunity Fund	37.55%	24.39%	11.36%	5.61%	112.82%	2/29/00	1.39% <sup>1</sup>	BIOPX
Large Cap	Baron 5 <sup>th</sup> Ave. Growth Fund	35.44%	18.25%	N/A	7.19%	95.59%	4/30/04	1.55%/1.30% <sup>1</sup>	BFTHX
All Cap	Baron Partners Fund <sup>3</sup>	47.63%	22.26%	12.37%	13.35%	1457.62%	1/31/92	1.40%+0.34% <sup>2</sup>	BPTRX
Int'l	Baron Emerging Markets Fund	14.71%	N/A	N/A	5.32%	16.81%	12/31/10	4.01%/1.50% <sup>2</sup>	BEXFX
	Baron Global Advantage Fund	29.78%	N/A	N/A	19.78%	35.10%	4/30/12	8.35%/1.50% <sup>2</sup>	BGAFX
	Baron Int'l Growth Fund	21.61%	16.58%	N/A	16.58%	115.38%	12/31/08	1.78%/1.50% <sup>2</sup>	BIGFX
Specialty	Baron Energy and Rsrcs Fund	25.32%	N/A	N/A	8.88%	18.55%	12/30/11	9.07%/1.35% <sup>2</sup>	BENFX
	Baron Real Estate Fund	27.12%	N/A	N/A	23.28%	130.94%	12/31/09	1.76%/1.35% <sup>2</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	38.69%	22.39%	10.66%	14.29%	1164.79%	12/31/94	1.06% <sup>1</sup>	BGRIX
	Baron Small Cap Fund	38.10%	22.00%	10.32%	10.71%	422.69%	9/30/97	1.05% <sup>1</sup>	BSFIX
Smid Cap	Baron Focused Growth Fund <sup>3</sup>	26.09%	19.46%	13.01%	12.12%	647.40%	5/31/96	1.16%/1.10% <sup>2</sup>	BFGIX
Mid Cap	Baron Asset Fund	39.25%	20.24%	10.39%	11.70%	1788.76%	6/12/87	1.06% <sup>1</sup>	BARIX
	Baron Opportunity Fund	37.90%	24.70%	11.50%	5.71%	115.44%	2/29/00	1.13% <sup>1</sup>	BIOIX
Large Cap	Baron 5 <sup>th</sup> Ave. Growth Fund	35.73%	18.52%	N/A	7.31%	97.78%	4/30/04	1.26%/1.05% <sup>1</sup>	BFTIX
All Cap	Baron Partners Fund <sup>3</sup>	48.02%	22.55%	12.50%	13.41%	1476.32%	1/31/92	1.13%+0.35% <sup>2</sup>	BPTIX
Int'l	Baron Emerging Markets Fund	15.02%	N/A	N/A	5.56%	17.64%	12/31/10	3.37%/1.25% <sup>2</sup>	BEXIX
	Baron Global Advantage Fund	30.13%	N/A	N/A	20.05%	35.60%	4/30/12	7.33%/1.25% <sup>2</sup>	BGAIX
	Baron Int'l Growth Fund	21.89%	16.87%	N/A	16.87%	117.99%	12/31/08	1.40%/1.25% <sup>2</sup>	BINIX
Specialty	Baron Energy and Rsrcs Fund	25.63%	N/A	N/A	9.13%	19.10%	12/30/11	8.65%/1.10% <sup>2</sup>	BENIX
	Baron Real Estate Fund	27.48%	N/A	N/A	23.57%	133.17%	12/31/09	1.44%/1.10% <sup>2</sup>	BREIX

Baron Growth Fund and Small Cap 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, 2012 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 1.55% Retail share class and 1.26% Institutional share class, but the net annual expense ratio is 1.30% Retail and 1.05% Institutional (net of the Adviser's fee waivers).

<sup>2</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).

<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.

Portfolio holdings as a percentage of net assets as of 9/30/13 for securities mentioned: Haitong Securities Co., Ltd. – 2.2%, Biostime International Holdings Ltd. – 2.5%, Sihuan Pharmaceutical Holdings Group Ltd. – 1.0%, DEN Networks Ltd. – 1.4%, Dish TV India Ltd. – 0.9%, Zee Entertainment Enterprises, Ltd. – 1.0%, Sun TV Network Ltd. – 0.9%, Kroton Educacional SA – 2.1%. Portfolio holdings may change over time.

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 and Baron Global Advantage 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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