

DEAR BARON REAL ESTATE FUND SHAREHOLDER:

We are pleased to report that the Baron Real Estate Fund (the "Fund") generated both strong absolute and relative performance in the quarter ended March 31, 2012. During this period, the Fund gained 15.59%, outpacing its primary benchmark, the MSCI USA IMI Extended Real Estate Index Net (the "MSCI Real Estate Index") that gained 13.84%. Baron Real Estate Fund's 15.59% advancement also outperformed the S&P 500 Index that gained 12.59%.

Why has the stock market performed well year to date in 2012? We believe many of the prevailing concerns of last year have begun to fade.

There are indications that the U.S. economy is recovering. The U.S. housing market has begun to mend. Banks are lending more readily, and factories have started to ramp up production. Consumer confidence is rebounding, although it is still below the level of optimism that existed prior to 2008. Concerns about Europe remain legitimate; however, substantial liquidity has been provided to strengthen the banking system and to offset the impact of the various austerity programs throughout the region.

PERFORMANCE

Table I.
Performance (Retail Shares)
Annualized for periods ended March 31, 2012

	Baron Real Estate Fund ^{1,2}	MSCI USA IMI Extended Real Estate Index ¹	S&P 500 Index ¹
Three Months ³	15.59%	13.84%	12.59%
One Year	6.71%	5.77%	8.54%
Since Inception (December 31, 2009)	18.77%	15.71%	13.24%

Performance listed in the above table is net of annual operating expenses. As of the last fiscal year ended December 31, 2011, annual operating expense ratio for the Retail Shares was 2.33%, but the net annual expense ratio was 1.35% (net of the Adviser's fee waivers). *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 has reimbursed certain Fund expenses and the Fund's transfer agency expenses may be reduced by expense offsets from an unaffiliated transfer agent, without which performance would have been lower. Current performance may be lower or higher than the performance data quoted. For performance information current to the most recent month end, visit www.BaronFunds.com or call 1-800-99BARON.*

¹ The MSCI USA IMI Extended Real Estate Index and the S&P 500 Index are unmanaged. The MSCI USA IMI Extended Real Estate Index is a custom index calculated by MSCI for, and as requested by, BAMCO, Inc. The index includes real estate and real estate-related GICS classification securities. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indexes or any securities or financial products. This report is not approved, reviewed or produced by MSCI. The S&P 500 measures the performance of large cap U.S. equities in the stock market in general. The indexes and the Fund include reinvestment of interest, capital gains and dividends, which positively impact the performance results.

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

³ Not annualized.



JEFFREY KOLITCH
PORTFOLIO MANAGER

If the U.S. economy continues to exhibit signs of recovery, we believe the Fund, with its balanced and diversified portfolio, should continue to perform well. Unlike most real estate funds that confine their investments primarily to real estate investment trusts ("REITs"), the Fund augments its REIT investments with a broader universe of real estate-related businesses that, at times, offer faster and more open-ended growth opportunities than typically found in REITs. Examples of non-REIT investments which we think have strong growth prospects include real estate services firm, **CBRE Group, Inc.**, tower operator, **SBA Communications Corp.**, and hotel operators, **Wyndham Worldwide Corp.**, **Hyatt Hotels Corp.**, and **Starwood Hotels and Resorts Worldwide, Inc.** For more thoughts on the Fund's portfolio construction, please see "Portfolio Structure" presented later in this letter.

We remain optimistic about the prospects for the Fund. For our perspective on real estate-related securities and the Fund for the balance of 2012, please see the "Outlook" section presented later in this letter.

Table II.
Top contributors to performance for the quarter ended March 31, 2012

	Quarter End Market Cap (billions)	Percent Impact
Equinix, Inc.	\$7.3	2.89%
Wyndham Worldwide Corp.	6.8	1.33
CBRE Group, Inc.	6.5	0.97
Capital Senior Living Corp.	0.3	0.95
Golar LNG Partners L.P.	1.5	0.74

In the first quarter of 2012, several of our real estate-related categories contributed positively to the Fund.

Equinix, Inc., an owner and operator of data centers, is the Fund's largest position and gained more than 50% in the first three months of 2012. Strong operating performance, and management's consideration of converting to a REIT, combined to propel the stock higher. Management has



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indicated that the company may grow revenues and cash flow by approximately 100% in the next four years, thus offering far superior growth than most REITs and other real estate-related companies.

Most notably, should Equinix ultimately decide to convert to a REIT, we believe the shares would respond positively because REITs, on average, are valued at approximately 20 times adjusted funds from operations ("operating cash flow") versus Equinix's present valuation of only 13 times operating cash flow.

Wyndham Worldwide Corp. has continued to be a positive contributor to the Fund following its strong share price performance in 2011. The company is benefiting from growth in its franchise, timeshare, and vacation and rentals businesses. Management has continued to allocate capital prudently, utilizing its high free cash flow to buy back shares, retire debt, increase its dividend, and acquire companies. We believe valuation remains attractive.

CBRE Group, Inc. ("CB Richard Ellis"), the global leading commercial real estate firm, has continued to benefit from a rebound in its leasing, investment sales, property management, and investment management businesses. We believe, with the recovery in the commercial real estate market, the company may double its earnings in the next four to five years. Management has set 2012 earnings guidance of at least \$1.20 per share, which we believe could grow to \$2.40 per share by 2016. Applying a 15 times multiple to \$2.40 per share in earnings would result in approximately 100% upside from today's share price.

Capital Senior Living Corp., a senior housing operator, has remained a top performer for the Fund. We recently increased our investment in the company and remain bullish about its prospects. For more on Capital Senior Living, please review our commentary in the "Recent Activity" section of this letter.

Table III.
Top detractors from performance for the quarter ended March 31, 2012

	Quarter End Market Cap or Market Cap When Sold (billions)	Percent Impact
RealPage, Inc.	\$1.4	-0.57%
Carnival Corp.	23.0	-0.23
Entertainment Properties Trust	2.1	-0.01

RealPage, Inc. is a leading provider of property management software for the rental housing industry. Its shares retreated sharply in the first quarter due to a decline in leasing transaction volumes late in 2011. We believe the shortfall is temporary and have purchased additional shares at lower prices because we remain optimistic about the long-term prospects for the company. In our opinion, RealPage is a compelling way to invest in the trend of Americans choosing to rent homes. The company has significant growth opportunities by increasing market share, adding new products, entering new markets, such as senior living and student housing, and engaging in acquisitions. We believe the shares can appreciate significantly in the next few years.

Carnival Corp. was negatively impacted due to concerns stemming from an accident with one of its cruise ships, rising oil prices, and nagging economic weakness in Europe. In the most recent quarter, we exited our position.

PORTFOLIO STRUCTURE

Our approach to portfolio construction is atypical. Unlike most real estate funds that confine their investments primarily to REITs, the Baron Real Estate Fund supplements its REIT investments with a broader universe of real estate-related businesses such as the following examples:

- Hotels & Leisure: **Hyatt, Starwood, Wyndham**
- Real estate service companies: **CB Richard Ellis, Costar**
- Senior housing operators: **Brookdale Senior Living, Capital Senior Living**
- Infrastructure companies: **Brookfield Infrastructure Partners**
- Data centers: **Equinix**
- Building product and services companies and homebuilders: **Stanley Black & Decker**
- Casino and gaming operators: **Penn National Gaming, Wynn Resorts**
- Tower operators: **SBA Communications**
- Real estate operating companies: **Brookfield Asset Management**

The Fund's expanded real estate-related categories are as follows:

Table IV.
Fund's investments in real estate categories as of March 31, 2012

	Percent of Net Assets
REITs	20.1%
Hotel & Leisure ¹	15.0
Real Estate Service Companies	13.7
Senior Housing Operators	10.4
Infrastructure-Related & MLPs	9.9
Data Centers ²	7.0
Building Products/Services	7.0
Casino & Gaming Operators	6.7
Tower Operators	6.6
Real Estate Operating Companies	2.5
	98.9
Cash and Cash Equivalents	1.1
	100.0%

¹ Total would be 17.1% if included hotel REIT LaSalle Hotel

² Total would be 8.5% if included data center REIT Digital Realty Trust

We favor our more expanded and inclusive approach to real estate portfolio construction for three key reasons:

1. REITs represent only a minority of the investable real estate universe.

There are 310 companies in the MSCI Real Estate Index. Of these:

- 55% (171 companies) are non-REIT companies.
- 45% (139 companies) are REITs.

At Baron, we strive to review and assess virtually all 310 MSCI real estate-related companies, both REITs and non-REITs, in our continuing effort to identify the most attractive investments.

We believe the Baron Real Estate Fund's more balanced approach of "not putting all of our eggs in one basket" is most sensible. In addition to our REIT investments, we include significant additional real estate-related

categories. In our opinion, this approach will be a winning formula for the long term.

2. We include companies that we think have superior and more open-ended growth potential than REITs.

We believe **CBRE Group, Inc.**, a leading real estate services firm, may grow its earnings by 100% over the next four to five years.

We believe **Equinix, Inc.**, a data center operator, may more than double its revenues and cash flow in the next 4 years.

We believe **SBA Communications Corp.**, a tower operator, will grow meaningfully faster than most REITs in the next few years.

3. REITs will not always be in vogue.

REITs have performed well in the last few years as investors searched for "safety," dividend income, and predictable cash flow in this uncertain economic and historically low interest rate environment. Just as "trees don't grow to the sky," REITs will not always be in favor.

Additional factors to consider related to REITs include:

REIT valuations at this time, in our opinion, may have become stretched relative to many other real estate categories.

REITs may be more vulnerable in a rising interest rate environment than other real estate categories.

REITs are required to pay out 90% of their taxable income in dividends, and, therefore, are more vulnerable if the debt or equity markets tighten up.

At March 31, the Fund maintained 42 positions. Our 10 largest holdings comprised 40.8% of the Fund with an average position size of 4.1%, and our 20 largest holdings accounted for 65.6% of the Fund with an average position size of 3.3%.

RECENT ACTIVITY

Table V.
Top net purchases for the quarter ended March 31, 2012

	Quarter End Market Cap (billions)	Amount (thousands)
CaesarStone Sdot-Yam Ltd.	\$0.4	\$530.1
Wynn Resorts Ltd.	12.6	495.5
Capital Senior Living Corp.	0.3	470.1
Sarana Menara Nusantara Tbk PT	1.5	452.3
CubeSmart	1.5	387.8

We have been increasing the Fund's exposure to companies that are expected to benefit from a rebound in the homebuilding market. Recent data suggests that U.S. housing fundamentals have begun to improve modestly. We favor building product and service companies (more so than homebuilders) because they will benefit not only from a pickup in new construction but also from a rebound in repair and remodeling activity by selling their products in both residential and commercial real estate markets.

Caesarstone Sdot-Yam Ltd. is a recent IPO. The company is the leading global manufacturer of high quality engineered quartz surfaces. Its products are used mainly for countertops in residential kitchen and bathroom renovation projects. Caesarstone also sells its products to commercial businesses. Major customers include Starbucks, Dunkin Donuts, and Goldman Sachs. We believe Caesarstone, with its quartz products, is a high-growth way

to play a recovery in residential construction and repair and remodeling activity. Sales of quartz are taking market share from other materials such as granite, marble, and laminate because it offers superior scratch, stain and heat resistance as well as a wider array of design options. From 1999-2000, quartz sales grew more than 16% annually versus approximately 4% growth of other materials in the global countertop industry.

At its recent IPO price of \$11 per share, we believe Caesarstone was attractively valued at less than nine times 2012 estimated earnings and may grow revenues by more than 100% over the next five years.

Interface, Inc. is the worldwide leader in the design, production and sales of modular carpet tiles. This product is gaining market share from traditional broadloom carpet because it is cheaper, easy to install new or to replace stained or damaged tiles, and offers many design options. The company has a number of opportunities for growth. Management believes that sales of carpet tiles, presently representing 33% of the U.S. office floor covering market, may grow to 65% by 2020. We expect Interface to also benefit from: (i) a rebound in commercial and residential construction; (ii) the rollout of its retail stores; and (iii) new uses by schools, government, retail, healthcare, and hotels. Europe and Asia also present attractive growth opportunities. After peaking at \$20 per share in 2011, Interface's share price declined as global economic activity remained weak. We recently began acquiring shares at \$12 per share, and are optimistic about the company's prospects over the next few years.

We began acquiring shares in **Wynn Resorts Ltd.**, following a correction in its share price from \$160 to \$120. It is a leading company in the gaming industry, with properties in two of the largest gaming markets in the world – Macau and Las Vegas. We are quite positive on the prospects for Wynn Resorts because of its exposure to improving business conditions in Las Vegas and growth opportunities in Asia, including the possibility for approval of a new project in Macau. Wynn enjoys strong free cash flow and earnings growth from the recent buyback of 20% of its shares.

Capital Senior Living Corp. remains one of our largest holdings. The company is a small capitalization operator of senior housing communities that has continued to benefit by acquiring "mom and pop" senior housing operators (1-5 properties) that fall below the radar of the larger senior housing companies and REITs. Recent acquisitions have been both accretive to earnings and generated significant cash flow growth. Acquisition prospects are also promising. We believe the company has the financial and operational capacity to acquire close to \$200 million of senior housing operators versus its current market capitalization of approximately \$250 million. We expect the company to also benefit from continued gains in occupancy and rental rates. We believe the shares are attractively valued and the company is an appealing acquisition target for larger senior housing operators, healthcare REITs, or private equity firms.

SBA Communications Corp. and **American Tower Corp.** have been favorites of the Fund. These tower operators combine the stability of traditional real estate (five to ten year lease agreements that generate stable and growing cash flow) with the fast growth of wireless devices such as the iPad, iPhone, and BlackBerry. Barriers to entry are high due to zoning restrictions that limit competing tower development.

We recently added a new company to our "tower portfolio" with the purchase of **Sarana Menara Nusantara Tbk PT** ("Protelindo"), Indonesia's

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largest independent wireless tower owner. The company is led by Michael Gearon, who successfully founded and built American Tower's international businesses. Following our due diligence, and our meetings with Michael, we are confident that he can replicate his prior achievements at American Tower by delivering strong growth at Protelindo. It is important to note that Indonesia, with approximately 245 million people, is the fourth largest country in the world and represents an attractive growth opportunity in this wireless market. We believe the company has the ability to double its size with its current tower development pipeline. Further, we believe the shares are attractively priced relative to its growth opportunity versus other tower operators.

Table VI.

Top net sales for the quarter ended March 31, 2012

	Quarter End Market Cap or Market Cap When Sold (billions)	Amount (thousands)
Carnival Corp.	\$23.0	\$-290.8
Entertainment Properties Trust	2.1	-290.5
American Tower Corp.	24.8	-224.0
Golar LNG Partners L.P.	1.5	-184.1
Tesoro Logistics LP	1.1	-149.4

In the most recent quarter, we exited our position in **Carnival Corp.** due to concerns stemming from an accident with one of its cruise ships, rising oil prices, and nagging economic weakness in Europe. We sold our successful investment in the REIT, **Entertainment Properties Trust** and redeployed the proceeds to companies we believe have more open-ended growth opportunities. Following strong performance in 2011, we decreased our exposure to **American Tower Corp.** and reallocated the capital to other tower operators, in our view, with more favorable valuations and faster growth prospects, such as **SBA Communications Corp.** and **Sarana Menara Nusantara Tbk PT. Tesoro Logistics LP** was a successful investment in 2011, generating a 43.3% return for the period held. We subsequently decreased our exposure and reallocated the capital to other MLPs that we believe have more favorable share return potential. The Fund exited **Owens Corning** following disappointing earnings results. We may reevaluate the company at a later date. Finally, we decreased our exposure to **Vornado Realty Trust** due to near-term concerns regarding a weak outlook for occupancy and rents in its Washington D.C. market.

OUTLOOK

Déjà vu? In both 2010 and 2011, the U.S. equity market performed well during the first quarter but stumbled in the second quarter. The age-old mantra of "sell in May and go away" would have served investors well. This year, 2012 first quarter results are strong once again. Will the U.S. stock market mirror the corrections of the last two years? As explained below, we believe that the remainder of this year will prove to be more positive.

Though there may be some lingering reasons to believe that the stock market may correct, once again, in 2012, due in part to high unemployment levels, rising oil and gasoline prices, Mideast instability, European debt issues and the slowdown in China's economic growth rate, we do not expect the stock market to plunge like it did in both 2010 and 2011 when the S&P 500 Index corrected by more than 15% and 20%, respectively. In fact, we would view any material weakness in the stock market as a buying opportunity for many of our favorite companies.

There are a number of reasons why we believe 2012 may behave better than the previous two years.

First, the trend of economic data for the U.S., though still sending mixed signals, has generally been positive. The job picture and housing market are modestly improving, inflation is tame, auto sales are rebounding, and corporate profits remain strong. Second, it appears that conditions in Europe, while still tenuous, are being addressed and are, in our opinion, largely discounted in the market. Third, we are not as concerned about a double-dip recession as we were last year. Fourth, bank lending has continued to improve and interest rates are at their lowest level in more than fifty years. Fifth, we believe that valuations of numerous companies that we are evaluating are attractive.

We also extend our positive outlook to real estate-related securities. After a five-year correction, the housing market has begun to stabilize and is now showing modest improvement in certain areas. In commercial real estate, the economic drivers of tenant demand are headed in the right direction and near-term construction growth is the lowest in years. Moderately increasing demand amidst forecasts of low supply bodes well for commercial real estate cash flow growth.

Table VII.

Top 10 holdings as of March 31, 2012

	Quarter End Market Cap (billions)	Investment Value (thousands)	Percent of Net Assets
Equinix, Inc.	\$ 7.3	\$1.6	7.1%
Capital Senior Living Corp.	0.3	1.4	6.2
Wyndham Worldwide Corp.	6.8	1.3	5.9
Hyatt Hotels Corp.	7.1	0.9	3.7
CBRE Group, Inc.	6.5	0.7	3.2
Brookdale Senior Living, Inc.	2.3	0.7	3.1
Stanley Black & Decker, Inc.	13.0	0.7	3.0
SBA Communications Corp.	5.6	0.7	3.0
RealPage, Inc.	1.4	0.6	2.8
Starwood Hotels & Resorts Worldwide, Inc.	11.1	0.6	2.8

We remain optimistic about the prospects for the Fund's holdings. We believe we have assembled a high-quality group of companies with excellent management teams, strong growth prospects, leading competitive positions, liquid balance sheets, and attractive valuations. Further, we continue to analyze new investment opportunities for addition to the Fund.

I am excited to be a major shareholder of the Baron Real Estate Fund alongside you.

Thank you for your continued support.

Sincerely,



Jeffrey Kolitch
Portfolio Manager
May 17, 2012

For more information about this Fund
please scan this QR code with any
bar code reader on your mobile device.



Baron Real Estate Fund is non-diversified, which means it may invest a greater percentage of its assets in fewer issues, and which increases the volatility of its returns and exposes it to potentially greater losses in a given period. In addition to general market conditions, the value of the Fund will be affected by the strength of the real estate markets. Factors that could affect the value of the Fund's holdings include the following: overbuilding and increased competition; increases in property taxes and operating expenses; declines in the value of real estate; lack of availability of equity and debt financing to refinance maturing debt; vacancies due to economic conditions and tenant bankruptcies; losses due to costs resulting from environmental contamination and its related clean-up; changes in interest rates; changes in zoning laws, casualty or condemnation losses; variations in rental income; changes in neighborhood values; and functional obsolescence and appeal of properties to tenants. The Fund may not achieve its objectives. Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

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 managers 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.

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