

## DEAR BARON EMERGING MARKETS FUND SHAREHOLDER:

## PERFORMANCE

Baron Emerging Markets Fund fell by 0.12% in the fourth quarter of 2011, while our principal benchmark index, the MCSI Emerging Markets IMI Growth Index Net, returned 4.03%. For the full year, the Fund declined 17.20%, outperforming the benchmark index decline of 20.04%. During the fourth quarter, the global equity market stabilized and began to recover earlier losses, which we attributed largely to escalating concerns over credit conditions in Europe and a deteriorating outlook for global economic growth. Emerging market equities underperformed the developed world for the year, particularly in U.S. dollar terms, as investors discounted slower growth, rising liquidity strains and related risk premiums. The silver lining is that during the fourth quarter, government and monetary authorities around the world began an increasingly aggressive easing cycle, which has the potential to improve global financial conditions and economic prospects. We are encouraged that the European sovereign credit markets and various measures of market liquidity have recently stabilized and now offer tentative signs of improvement. In our view, as stated in our third quarter letter, stabilization of such factors and further monetary easing would likely lead to positive equity returns, as most stocks were already discounting some likelihood of a second global financial crisis during much of the second half of 2011.

**Table I.**  
Performance (Retail Shares)<sup>†</sup>  
Annualized for periods ended December 31, 2011

	Baron Emerging Markets Fund <sup>1,2</sup>	MSCI EM (Emerging Markets) IMI Growth Index Net <sup>1</sup>	MSCI EM (Emerging Markets) IMI Index Net <sup>1</sup>
Three Months <sup>3</sup>	-0.12%	4.03%	3.84%
One Year and Since Inception (December 31, 2010)	-17.20%	-20.04%	-19.49%

Performance listed in the above table is net of annual operating expenses. The estimated annual operating expense ratio is 4.46%. The net annual expense ratio for the Retail Shares is 1.50% (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 for Baron Emerging Markets Fund, 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](http://www.BaronFunds.com) or call 1-800-99BARON.*

<sup>†</sup> If the Fund's historical performance was impacted by gains from IPOs and/or secondary offerings, there is no guarantee that these results can be repeated or that the Fund's level of participation in IPOs and secondary offerings will be the same in the future.

<sup>1</sup> The MSCI EM (Emerging Markets) IMI indexes cited are unmanaged, free float-adjusted market capitalization weighted indexes reflected in U.S. dollars. The MSCI EM (Emerging Markets) IMI Growth Index Net and the MSCI EM (Emerging Markets) IMI Index Net are designed to measure equity market performance of large-, mid- and small cap securities in the emerging markets. The MSCI EM (Emerging Markets) IMI Growth Index Net screens for growth-style securities. The indexes and Baron Emerging Markets Fund include reinvestment of dividends, net of foreign withholding taxes, which positively impact the performance results.

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

<sup>3</sup> Not annualized.



MICHAEL KASS  
PORTFOLIO MANAGER

For the fourth quarter, the Fund's relative performance trailed our benchmark, though it exceeded the benchmark for the full year. During the quarter, strong stock selection in the Energy, Financials and Materials sectors were more than offset by weak selection in Information Technology, Consumer Discretionary and Telecommunication Services sectors. Within Information Technology, a number of our companies suffered from market fears over a global economic contraction after having performed quite well earlier in the year, leading to substantial percentage declines during the quarter. Our cash position also detracted from relative performance during the quarter. For the full year, we outperformed our benchmark, partially due to launching the Fund in January with a view that the emerging markets were facing considerable headwinds. We were somewhat cautious early in the year, emphasizing well-capitalized, stable businesses with strong returns and cash flow characteristics, particularly in markets we considered somewhat overheated such as China, Brazil and India. A modest cash cushion, maintained throughout the year, contributed to our relative performance. For the year, our stock performance was driven by positive selection in the Financials, Materials, Health Care and Information Technology sectors, offset by poor performance in Consumer Staples, Consumer Discretionary, Telecommunication Services and Energy. Our bias towards smaller and mid-capitalization companies during the year also weighed on performance relative to our benchmark, as these categories notably lagged larger cap stocks.

**Table II.**  
Top contributors to performance for the quarter ended December 31, 2011

	Percent Impact
Metro Pacific Investments Corp.	0.41%
Itaú Unibanco Holding SA	0.38
Exillon Energy plc	0.34
OGX Petróleo e Gás Participações SA	0.32
Qualicorp SA	0.30

**Metro Pacific Investments Corp.** is a holding company for investments in real estate and infrastructure projects in the Philippines. The company holds stakes in water, power, toll



# Baron Emerging Markets Fund

roads, and hospitals. The Philippines is investing significantly to upgrade the country's infrastructure through public-private partnerships (PPPs). The expectation that the Philippine government will commence PPP awards soon caused Metro Pacific shares to rise. We think Metro Pacific is well-positioned to be awarded attractive projects. (Rebecca Ellin)

Shares of Brazilian bank **Itaú Unibanco Holding SA** rose 19.6% for the quarter. The shares performed well due to solid third-quarter results, including strong loan growth, controlled credit costs, and strong earnings growth of 25% year over year. We like Itau because we think it is well-managed, has a bright credit-growth profile and should see margins improve as cost synergies from the Itau/Unibanco merger are recognized. (Rob Susman)

**Exillon Energy plc** is an independent oil and gas company with all of its operations in two large basins in Russia. The company is one of the few independents with exclusive operations in Russia and is growing its production through the application of more modern technology and development drilling techniques to these historically prolific areas. During the quarter, the shares benefited principally from reports that its production volumes were running ahead of expectations and, to a lesser extent, from higher oil prices. (Jamie Stone)

**Table III.**  
Top detractors from performance for the quarter ended December 31, 2011

	Percent Impact
Financial Technologies Ltd.	-0.84%
Mahindra & Mahindra Ltd.	-0.43
Anhanguera Educacional Participações SA	-0.40
NII Holdings, Inc.	-0.37
Kingdee International Software Group Co. Ltd.	-0.35

**Financial Technologies Ltd.** provides IT platforms to create financial markets across all asset classes. The company has launched trading exchanges in India, Africa, the Middle East, and Southeast Asia. FT India's trading volumes contracted in response to deteriorating financial conditions. Despite the uncertainty and the poor current trading conditions, which, in our opinion, is well-reflected in the current valuation, we continue to believe FT India is well-positioned to benefit from a long-term expansion of capital markets activities. (Michael Kass)

**Mahindra & Mahindra Ltd.** is the market leader in India in agricultural tractors and utility vehicles. It also has businesses in financial services, IT outsourcing, and hospitality services. Mahindra's shares declined in step with the Indian market over fears of deteriorating growth and stubbornly high inflation. The company has demonstrated impressive growth and, in our view, remains well-positioned for the long term, particularly in the farm-equipment business. We believe agricultural yield enhancement is an attractive thematic opportunity in India and throughout the developing world. (Michael Kass)

**Anhanguera Educacional Participações SA's** shares declined 16.3% during the fourth quarter. The leading private, post-secondary education company in Brazil, Anhanguera recently completed the largest acquisition in its history. While the acquisition will further consolidate this highly fragmented market and provide further scale for Anhanguera in the Sao Paulo region, the company will suffer from short-term margin compression

as the acquiree's less-efficient operation is absorbed by the company. (Kyuhey August)

## PORTFOLIO STRUCTURE

**Table IV.**  
Top 10 holdings as of December 31, 2011

	Percent of Net Assets
OGX Petróleo e Gás Participações SA	2.3%
TOTVS SA	2.3
Itaú Unibanco Holding SA	2.2
Bank Rakyat Indonesia (Persero) Tbk PT	2.2
CFR Pharmaceuticals SA	2.2
Daum Communications Corp.	2.0
Anhanguera Educacional Participações SA	1.9
Dah Chong Hong Holdings Ltd.	1.9
Exillon Energy plc	1.9
Qualicorp SA	1.9

## EXPOSURE BY COUNTRY

**Table V.**  
Percentage of securities by country as of December 31, 2011

	Percent of Net Assets
Brazil	18.3%
India	12.6
China	7.8
Indonesia	6.5
Korea	6.2
Philippines	5.0
Chile	4.9
Mexico	4.2
United States	3.9
Hong Kong	3.7
Taiwan	3.6
Canada	3.1
Thailand	2.5
Russia	1.9
South Africa	1.7
Norway	1.6
United Arab Emirates	0.8

**Exposure by Market Cap:** The Fund may invest in companies of any market capitalization, though we have generally focused on mid and smaller cap companies, as we believe such companies often have more attractive growth potential. At the end of the fourth quarter of 2011, the Fund's median market cap was \$2.1 billion, and we were invested approximately 19.3% in companies with market caps over \$10 billion, 22.4% in companies with market caps between \$2.5 and \$10 billion and 46.6% in companies with market caps under \$2.5 billion.

## RECENT ACTIVITY

During the fourth quarter, we made several adjustments to the portfolio in response to changing company fundamentals as well as the deteriorating financial and liquidity conditions transpiring in the global capital markets. In general, our goal was to move further up the quality ladder with a

preference for strongly capitalized companies with a likelihood of significant cash generation in the near to mid-term. In addition, we added to several positions on market weakness where we continue to believe the long-term fundamental outlook remains compelling. We note that the recent poor performance in most emerging market countries has triggered several new investment candidates in companies we have admired, though we never felt offered a compelling investment return. As we move into 2012, we are increasingly enthusiastic about potential new investments and we are diligently moving forward with such research.

## OUTLOOK

Last quarter, we commented that it is critical that the evolving European sovereign debt and bank funding crisis stabilize in order to calm markets and allow fundamental value to be restored in equities. After several trial balloons during the quarter, European authorities finally delivered details of a compromise plan in December, and while we applaud the significant progress, we caution that it likely falls somewhat short of the "fiscal union" that could mark a definitive turning point in the crisis. Germany offered the weaker sovereign nations a stick without the carrot – new procedures for enforcing austerity commitments without compromise on a direct role for the European Central Bank ("ECB") or the introduction of Eurobonds to support sovereign debt. Thus, for now, we conclude it remains politically unacceptable for the ECB, and by default, Germany, to act as a backstop in the event of a default or bailout of a weaker Euro sovereign. The ECB did agree to offer unlimited lending at very favorable terms to European banks, which should, at a minimum, stabilize the bank funding crisis. However, the question remains whether this strategy can lead to declining sovereign borrowing rates and greater demand from private market and bank investors. Further, we note that the individual European countries will hold referendums or elections in coming months to ratify new commitments and terms. These are the key

variables we will be monitoring to determine if the European crisis is indeed fading as we move into 2012.

China is the other key variable to monitor as it often acts as a leading indicator of global economic and market conditions. Though recent developments have not been confidence inspiring, as evidenced by weak exports, capital outflows, signs of a property market correction and declining equities, we note that such weakness has sparked the beginning of an easing campaign. If the financial stress related to Europe improves and China signals a greater commitment to ease lending conditions, we would anticipate a noticeably more favorable investment environment in the year ahead. Indeed, the global easing cycle, which clearly began in the fourth quarter in response to the European crisis, has already been an important support for equities. As always, we approached the recent market volatility opportunistically to add to existing positions and to initiate new investments in **AsialInfo-Linkage, Inc., M. Dias Branco SA, Dish TV India Ltd., Tower Bersama Infrastructure Tbk PT, Jubilant FoodWorks Ltd., Ubiquiti Networks, Inc., and Agrinos AS.** We look forward to our next quarterly update.

**Thank you for investing in the Baron Emerging Markets Fund.**

Sincerely,

Michael Kass  
Portfolio Manager  
January 18, 2012

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



*The Fund's investments in developing countries are subject to all of the risks of foreign investing, generally, and have additional heightened risks due to a lack of established legal, political, business and social frameworks to support securities markets, including: delays in settling portfolio securities transactions; currency and capital controls; greater sensitivity to interest rate changes; pervasiveness of corruption and crime; currency exchange rate volatility; and inflation, deflation or currency devaluation. The Fund may not achieve its objectives. Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.*

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