

DEAR ENERGY AND RESOURCES FUND SHAREHOLDER:

PERFORMANCE

The second quarter proved to be a challenging period for the Baron Energy and Resources Fund, as the Fund declined by just over 5% in value during the quarter, which, while broadly in line with its primary benchmark, the S&P North American Natural Resources Sector Index, was still disappointing. That being said, we think it is important to remain focused on the longer term, and both our year-to-date absolute and relative performance results are quite solid with the Fund rising 5.81% and outperforming its benchmark by almost 400 basis points. The Energy and Resource sectors of the broader market continue to be out of favor with investors. Within this broader category, the Materials and Mining sub-sectors have been perhaps the biggest laggards for an extended period of time now. The underperformance in these sectors, which comprise the bulk of our Fund's investments, is attributable to the ongoing concerns about global economic growth and in particular emerging market economic growth, which continued to deteriorate during the second quarter.

On an absolute basis our performance was most impacted by a 3.9% negative contribution from our Energy positions, which was largely driven by three factors in the quarter: 1) several of our companies, such as **CARBO Ceramics, Inc.** and **Subsea 7 SA** experienced big downward moves related to earnings disappointments, while companies such as **Halcon Resources Corp.**, were negatively impacted by worse than expected drilling results; 2) our overweight position in MLP/Midstream-related companies was negatively impacted by concerns surrounding the impact on valuations from the rise in U.S. interest rates; and 3) although we only had a small position in refining and marketing companies, those stocks suffered from continued pressure

Table I.  
Performance (Retail Shares)  
Annualized for periods ended June 30, 2013

	Baron Energy and Resources Fund <sup>1,2</sup>	S&P North American Natural Resources Sector Index <sup>1</sup>	S&P 500 Index <sup>1</sup>
Three Months <sup>3</sup>	-5.21%	-4.95%	2.91%
Six Months <sup>3</sup>	5.81%	1.87%	13.82%
One Year	14.93%	10.62%	20.60%
Since Inception (December 30, 2011)	0.07%	2.72%	20.36%

Performance listed in the above table is net of annual operating expenses. As of the last fiscal year ended December 31, 2012, annual operating expense ratio for the Retail Shares was 9.07%, 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 (by contract as long as BAMCO, Inc. is the adviser to the 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>1</sup> The indexes are unmanaged. The S&P North American Natural Resources Sector Index measures the performance of U.S.-traded natural resources related stocks, including mining, energy, paper and forest products, and plantation owning companies and the S&P 500 Index of 500 widely held large-cap U.S. companies. The indexes and the Fund are with dividends, which positively impact the performance results.  
<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 redemption of Fund shares.  
<sup>3</sup> Not annualized.



JAMES STONE  
PORTFOLIO MANAGER

throughout the quarter on refining margins, as benchmark oil price differentials tightened faster than expected. Even though we were underweight in Materials relative to our benchmark and prudently reduced our exposure to this sector during the quarter, we still experienced a negative contribution from almost all of our positions in this area, which contributed another 80 basis points of negative return during the quarter.

We launched the Baron Energy and Resources Fund at the beginning of 2012, but this is our first quarterly shareholder letter and so we would like to start by welcoming all of our investors and thanking you for entrusting us with your capital and your confidence. The mission and purpose of the Baron Energy and Resources Fund is to provide our investors with a differentiated fund that seeks to capitalize on the long-term growth opportunities that we see primarily in the Energy sector, but also in a number of other Resource and Industrial related sectors. We believe that this is an exciting period in the evolution of the energy business, as new technologies are causing substantial changes in the global energy landscape, creating the kinds of dislocations and creative destruction that often leads to great investment opportunities. Our Fund's energy focus is primarily on companies in oil & gas and related businesses, which is where we currently see the best investment opportunities, but we acknowledge that this could change over time.

Similar to the other Baron Funds, we are long-term investors with a three-to-five-year time horizon and a focus on companies with top tier growth potential that are well-financed and have strong, entrepreneurial management teams. While it is not always easy to find companies in the Energy, Resource or Industrial sectors that have "moats" or conventionally defined competitive advantages, we do look for certain attributes in companies or management teams that do ultimately create competitive advantage and above average shareholder returns.\* Examples of this can be unique technological capabilities, differentiated products and competitive positioning, first mover advantages, specialized basin knowledge, and a proven track record of superior capital allocation. We will discuss the portfolio construction later on in this letter, but in brief, the Fund seeks to be different from its peer funds by having a more concentrated portfolio of 45-55 different investments and, while it is an



# Baron Energy and Resources Fund

all-cap fund, our investors should expect a greater concentration of small-to-mid cap companies in the portfolio rather than the large mega-cap oil majors, for example. Lastly, we have and expect to continue to have a very high Active Share\*\* as we build the portfolio from the bottom-up in a research intensive process that is consistent with my background as an Energy analyst for the past 25 years and with the Firm's background over the past 30 years.

Currently, we think that the investment environment for the Energy sector is excellent but not as attractive in the near term for other parts of the Resource-related industries like Mining and Metals. The sluggish growth in the global economy and, in particular, the slowdown in emerging market economies in the last 12-24 months has not had as significant an impact on energy demand as it has had on the demand for other commodities. At the same time, while supplies of energy have grown in North America, they have been flat to declining in other parts of the world, enabling prices to be relatively stable for oil and natural gas. By contrast, commodity prices for copper, gold, steel, coal and a host of other commodities have been very weak and have put significant pressure on suppliers of those products and companies that sell products to those industries. Therefore, we have been reducing our exposure to the non-energy resource sectors over the past six months.

Over the past several years, our investment strategy within the Energy sector, whether for the other Baron Funds or since the inception of this Fund, has been focused on several key themes. As a result, the companies we believe are best positioned to benefit from these themes continue to dominate our portfolio. The three key themes have been: 1) the growth opportunity for exploration & production, oilfield service and midstream companies due to the ongoing development of unconventional oil & gas in North America (shale oil & gas, in particular); 2) the shift in offshore exploration and development into ever deeper water around the world; and 3) the need for a significant increase in new infrastructure investment as the production locations and consumption patterns around the world are shifting at a faster rate than we have historically experienced. We think these themes will continue to provide us with fertile investment opportunities over the balance of the decade, and our challenge is to continue to seek out those companies that offer the best balance of risk and reward.

**Table II.**  
Top contributors to performance for the quarter ended June 30, 2013

	Year Acquired	Percent Impact
Chart Industries, Inc.	2012	0.47%
Tesoro Logistics LP	2012	0.40
Oil States International, Inc.	2012	0.37
Scorpio Tankers Inc.	2013	0.26
Western Gas Equity Partners LP	2012	0.25

**Chart Industries, Inc.** is a leading global manufacturer of highly engineered equipment used in the production, storage, and end use of natural and industrial gases. As the global development of LNG infrastructure continues to grow, we believe Chart will have the ability to increase capacity and profitability. During the second quarter, Chart continued to see accelerating orders from China, which coupled with the approval by the U.S. government of a second LNG export facility on the Gulf Coast, increased investors' conviction in the strength and the duration of current cycle for expanded LNG production and consumption. This in turn sent the stock to all-time highs.

**Tesoro Logistics LP** is a fee-based, growth-oriented publicly traded master limited partnership that owns, operates, develops, and acquires crude oil and refined products logistics assets. Tesoro Logistics units outperformed in

the second quarter, as management executed on growth projects (e.g., Chevron's pipeline acquisition) and developed new growth projects (e.g., Carson acquisition from BP for \$1.5 billion). We like the company's top-tier cash flow growth and supportive General Partner.

**Oil States International, Inc.** is a diversified oilfield services & equipment company that focuses on remote location accommodations, specialized equipment for deepwater drilling and field development, and unconventional resource completion activity. Oil States shares benefited in the quarter from shareholder activism that focused on converting its accommodations business into a REIT as a means to unlock significant value. Management appears to be inclined to pursue this strategy, and we see additional upside in the shares based on this potential restructuring.

**Scorpio Tankers Inc.** provides marine transportation of petroleum products worldwide. During the second quarter, the company raised \$300 million in an equity offering, which allowed it to take additional orders and lockup shipyard capacity for construction of a fleet of more efficient tankers. By 2015, we expect Scorpio to be the market leader of the eco-product tankers. With this position, we expect the company to increase its cash flow dramatically over the next two years and return cash to shareholders through increased dividends and buybacks.

**Western Gas Equity Partners LP** is the General Partner (GP) of Western Gas Partners, a growth-oriented master limited partnership (MLP) formed by Anadarko. The MLP has the ability to propel growth through a combination of acquisitions and organic projects, and the GP will benefit from this growth through its incentive distribution rights ownership. During the second quarter, the GP contributed to performance as the MLP continued to grow in the current environment, and the GP declared its first increase in distribution in line with IPO guidance.

**Table III.**  
Top detractors from performance for the quarter ended June 30, 2013

	Year Acquired	Percent Impact
Halcon Resources Corp.	2012	-0.93%
CARBO Ceramics, Inc.	2012	-0.70
Subsea 7 SA	2012	-0.49
C&J Energy Services, Inc.	2012	-0.46
Concho Resources, Inc.	2012	-0.44

**Halcon Resources Corp.** is an emerging growth company in the independent exploration and production sub-industry. The company is well-positioned in several key unconventional oil plays around the country. The shares in the second quarter were negatively impacted by worse than expected initial drilling results from its Utica shale play in Ohio and concerns that its recent spending spree would prompt the need for additional capital raises. Halcon actually did raise capital in early June, and that event appears to have stabilized the share price. We continue to like Halcon's asset base and value proposition.

**CARBO Ceramics, Inc.** is the largest provider of ceramic proppants to the global oil & gas industry. Ceramic proppants are a key material in the hydraulic fracturing process; however, demand and pricing for these proppants has been hurt by a combination of reduced natural gas drilling and increased foreign competition. Competitive pressures appear to be easing, and CARBO's volumes and cost pressures appear to be stabilizing, so we expect volumes and margins to improve in the second half of the year. Nevertheless, reduced earnings expectations hurt the shares in the second quarter.

**Subsea 7 SA** is a U.K.-based offshore construction company that operates worldwide and specializes in deepwater oil & gas related construction activities. Subsea 7 shares were negatively impacted in the second quarter by a profit warning late in the quarter related to continuing cost overruns on a particular job in Brazil. The company has been struggling with this particular project for over a year, and the recent cost overruns were unexpectedly worse than prior management guidance. We believe this is an isolated issue, and we believe that the rest of the business is performing well and continuing to build backlog to drive long-term earnings growth.

**C&J Energy Services, Inc.** is a small-cap oilfield services company that specializes in providing well completion and remediation services. Its primary business is hydraulic fracturing of unconventional oil & gas wells in the U.S. C&J's business has underperformed expectations due to weakness in fracturing demand relative to the available supply of equipment, which has pressured pricing and margins beyond forecasts. Reduced earnings expectations and slower growth of its own capacity have hindered the share price. We exited our position in C&J during the quarter.

**Concho Resources, Inc.** is an independent exploration and production company focused on the Permian Basin in West Texas. Concho shares suffered in the quarter from poor first quarter results, due to lower than expected production growth and price realizations. We believe that these factors are transitory and that Concho's production growth for the year will match or exceed expectations. The company is also significantly expanding its future inventory of drilling locations through its drilling program, which should also add material value over the next several years.

## PORTFOLIO STRUCTURE

The Fund is structured to be predominantly an energy fund with around 80% of the assets invested in energy and energy related companies, with the balance in materials, industrials, metals, chemicals, agricultural, paper & forest products and other areas of the natural resource spectrum. In addition, we expect to run a relatively concentrated portfolio of 45-55 distinct investments across all market caps. However, one should expect a bias toward small and mid-cap companies because these are the companies that we believe have the strongest long-term growth potential. Because the Energy and Resource sectors are global businesses, it will not be unusual to have 20-25% of the Fund's assets invested in international companies, although currently, we have a higher bias toward U.S. companies. Currently, the top ten positions comprise about 37% of the Fund with our largest position being Concho Resources, a U.S. independent exploration & production company that we believe is extremely well-positioned to double its production and cash flows over the next three-five years, yet trades at a material discount to its net asset value and its high growth peers in the same sector. On a sub-industry basis, our largest weight is toward exploration & production companies at 30.9% of assets, followed by the oilfield services & equipment sub-industry at 29.9%. Refining and marketing companies are only 2.3% of assets and the oil & gas transportation and storage sub-industry is another 23.1% putting our overall Energy allocation at 86.2%. We do not have any exposure to integrated oils, as these companies tend to be very slow growing and are not likely to be a material part of our strategy. Our high weighting in the transportation and storage segment is largely through MLPs and GPs that provide modest yields but because of high expected distribution growth should generate high-teens or better total annual returns over the next several years. In the non-Energy part of the Fund, 5.0% is allocated to Materials and 8.1% to Industrials. During the course of the second quarter, we reduced our exposure to Materials and Industrials.

Table IV.

Top 10 holdings as of June 30, 2013

	Year Acquired	Market Cap When Acquired (billions)	Quarter End Market Cap (billions)	Amount (thousands)	Percent of Net Assets
Concho Resources, Inc.	2012	\$10.1	\$8.8	\$853.9	4.4%
Forum Energy Technologies, Inc.	2012	1.7	2.8	799.1	4.1
SM Energy Co.	2012	4.9	4.0	764.6	4.0
Superior Energy Services, Inc.	2012	2.4	4.1	751.1	3.9
Oasis Petroleum, Inc.	2012	2.8	3.6	747.3	3.9
Oil States International, Inc.	2012	4.0	5.1	740.5	3.8
Bonanza Creek Energy, Inc.	2013	1.2	1.4	680.7	3.5
Tesoro Logistics LP	2012	1.0	2.8	605.4	3.1
Noble Energy, Inc.	2013	21.2	21.5	579.3	3.0
Halliburton Co.	2012	31.4	38.9	567.2	2.9

## RECENT ACTIVITY

Table V.

Top net purchases for the quarter ended June 30, 2013

	Quarter End Market Cap (billions)	Amount (thousands)
Concho Resources, Inc.	\$8.8	\$751.1
Superior Energy Services, Inc.	4.1	647.8
Oasis Petroleum, Inc.	3.6	639.4
Bonanza Creek Energy, Inc.	1.4	635.1
SM Energy Co.	4.0	628.9

During the quarter, we experienced a strong inflow of new assets, which enabled us to make modest adjustments to the weightings in our portfolio. Among the changes, we increased exposure to the Exploration & Production sector as well as an overall increase in portfolio concentration with the top 10 and top 20 positions becoming a bigger portion of the portfolio. As a result, companies such as **Concho Resources, Inc.**, **Oasis Petroleum, Inc.**, **Bonanza Creek Energy, Inc.** and **SM Energy Co.** were among our top net purchases in the quarter. The increased exposure to the Exploration & Production sector came largely at the expense of Metals and non-Energy Industrials, and we maintained our relatively strong weighting toward the Midstream/MLP sector, even though several of these stocks dropped out of the top 10.

None of our top net purchases represented new positions for the Fund, but our largest new position in the quarter is **Noble Energy, Inc.** Noble is a U.S. based independent exploration & production company, with pre-eminent positions in two of the most interesting shale developments in the U.S.: the Niobrara Wattenberg shale play in Colorado and the Marcellus Shale in Pennsylvania/West Virginia. These two assets are growing rapidly and bringing significant growth of lower cost, higher margin production to Noble. At the same time that Noble accelerates its growth around these two assets, it has also built a strong portfolio of domestic and international offshore finds that we think should contribute significantly to its long-term growth. In particular, we anticipate that Noble's two large gas developments off the coast of Israel in the Mediterranean, as well as several developments in West Africa can combine with the aforementioned onshore U.S. assets to enable Noble to achieve top tier growth among its peers and generate superior shareholder returns.

# Baron Energy and Resources Fund

Table VI.  
Top net sales for the quarter ended June 30, 2013

	Amount (thousands)
C&J Energy Services, Inc.	\$-76.7
Joy Global, Inc.	-41.4
Key Energy Services, Inc.	-35.5
Sandstorm Gold Ltd.	-22.8
Globe Specialty Metals, Inc.	-17.0

We continued to scale back our investments in the Metals and Materials sectors during the quarter, as the outlook for those sectors worsened on an absolute basis and was particularly challenging relative to the investment opportunities that we continued to source in the Energy sector. While we did exit our positions in **C&J Energy Services, Inc.** and **Key Energy Services, Inc.**, two domestic oilfield service companies, we did so to reallocate capital to more attractively positioned companies in the domestic energy market. In both cases, we were troubled by the continuing deterioration in earnings forecasts and the potential for further earnings downgrades. Our sale of **Sandstorm Gold Ltd.** was the result of our more negative outlook for gold prices, coupled with what we deemed to be a shift in Sandstorm's strategy following a couple of recent deals on its part. **Joy Global, Inc.** is a company that we like over the long term as one of two main suppliers of mining capital equipment to the global mining industry and is a company that we plan to revisit in the future. However, the outlook for mining capital investment is declining faster than we anticipated and the ongoing weakness in coal and metals markets makes it likely that an investment in Joy Global will at best be "dead money" for the foreseeable future.

## OUTLOOK

As we look into the second half of this year and beyond, we remain optimistic about the opportunities to invest in excellent companies with strong growth opportunities run by top-notch managers, particularly in the Energy sector. Our challenge is trying to identify which are going to be the best investments and buy them at the right values. We are confident in the long-term growth opportunities within Energy that are resulting from the key themes of unconventional resource development, deepwater exploration and development, and global infrastructure that we discussed earlier in this letter. That being said, it does not mean that we are not mindful of the volatility that is inherent in the energy business that results from the volatility in commodity prices and the importance of underlying global economic activity to the health of the business.

*Investors should consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The Baron Family of Funds is described in prospectuses which contain this and other information about the Funds. You should carefully read the prospectus before investing. You can obtain a copy of the prospectus by contacting the Funds' distributor, Baron Capital, Inc., at 767 Fifth Avenue, New York, New York, 10153, or by calling 1-800-99BARON, or by going to our website at [www.BaronFunds.com](http://www.BaronFunds.com).*

*\*According to Morningstar, companies with the ability to withstand the competition for a long time receive Wide moat ratings, companies with moderate ability to withstand competitive pressures receive Narrow moat ratings, and companies without meaningful competitive advantages receive None moat ratings.*

*\*\*Active Share is a term used to describe the share of a portfolio's holdings that differ from that portfolio's benchmark index. It is calculated by comparing the weight of each holding in the Fund to that holding's weight in the benchmark. Positions with either a positive or negative weighting versus the benchmark have Active Share. An Active Share of 100% implies zero overlap with the benchmark. Active Share was introduced in 2006 in a study by Yale academics, M. Cremers and A. Petajisto, as a measure of active portfolio management.*

*The Fund is non-diversified, which means the volatility of the Fund's returns may increase and expose the Fund to greater risk of loss in any given period. Energy companies can be affected by fluctuations in energy prices and supply and demand of energy fuels. Resources industries can be affected by international political and economic developments, the success of exploration projects, and meteorological events.*

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 Emerging Markets Fund by anyone in any jurisdiction where it would be unlawful under the laws of that jurisdiction to make such offer or solicitation.

Currently, we are quite optimistic that while economic growth is by no means robust, it is gradually getting better and could get meaningfully better in the U.S. in the next six to twelve months, and that is the kind of environment that is conducive to improved capital investment in new drilling and new infrastructure. Oil and gas commodity markets have faced substantial challenges in the last couple of years due to the changing nature of the supply picture in North America and due to low demand growth. However, in both instances, and particularly in the oil market, pricing has proven to be quite resilient. While the recent significant surge in oil prices may prove to be short-lived and may once again induce volatility into stock prices, we think that the strength in prices in the first half of this year and really for the last several years in the face of rising global supply, mediocre demand, and general bearishness among financial speculators has demonstrated that the market for oil is actually relatively tight and may stay that way for the foreseeable future.

Even though we do not predicate our investments on a specific forecast for the direction of oil and gas prices, analysis of these markets is still a big part of our process, as is stress testing our investments under different price and economic scenarios. While the current price of the commodity has recently moved sharply higher, it has not really impacted the longer-dated futures prices or driven share prices up too far too fast. As a result, we believe that valuations remain attractive, as there are a large number of stocks that we estimate are currently discounting prices, particularly oil prices, which are much lower than the spot price. Therefore, we are quite comfortable with the positioning of the portfolio at this time.

**I am pleased to have had the opportunity to share my thoughts with you in this letter. Thank you for having the confidence to join me in investing in Baron Energy and Resources Fund.**

Sincerely,



James Stone  
Portfolio Manager  
July 23, 2013

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