**December 31, 2018**

# Baron Energy and Resources Fund

## Dear Baron Energy and Resources Fund Shareholder:

## Performance

### Table I.
### Performance
**Annualized for periods ended December 31, 2018**

| | Baron Energy and Resources Fund Retail Shares[1,2] | Baron Energy and Resources Fund Institutional Shares[1,2] | S&P North American Natural Resources Sector Index[1] | S&P 500 Index[1] |
|---|---|---|---|---|
| Three Months[3] | (29.82)% | (29.76)% | (23.47)% | (13.52)% |
| One Year | (25.27)% | (25.03)% | (21.07)% | (4.38)% |
| Three Years | (4.48)% | (4.23)% | 1.50% | 9.26% |
| Five Years | (12.33)% | (12.12)% | (6.50)% | 8.49% |
| Since Inception (December 30, 2011) | (6.73)% | (6.51)% | (2.28)% | 12.70% |

JAMES STONE

PORTFOLIO MANAGER

Retail Shares: BENFX
Institutional Shares: BENIX
R6 Shares: BENUX

The fourth quarter was extremely challenging for the overall stock market and for energy and resource-related shares. The S&P 500 Index posted a loss of 13.5%, which was the worst quarterly loss since the "taper tantrum"/credit rating downgrade driven losses in the third quarter of 2011. For the S&P 500 Energy Index and the S&P North American Natural Resources Sector Index, the declines of 23.8% and 23.5%, respectively, represented the sharpest losses since late in 2008. Oil prices also fell 38% in the fourth quarter, posting the steepest quarterly decline since 2014 (-41%). It is clear to us that a combination of fears surrounding slowing growth in the global economy that have been spurred by a combination of slowing growth in emerging markets and rising fears surrounding tariffs and trade wars had a significantly negative impact on the broad stock market, and this bled over into commodity markets and the market for commodity-related shares, such as energy shares.

In addition to fears that slowing economic growth would negatively impact the demand for oil, investors also became increasingly concerned once again about supply growth. U.S. oil production growth surprised to the upside growing in October at a rate of nearly 1.9 million barrels per day year-over-year. At the same time, it also became clear that "OPEC +" (OPEC plus Russia, and several other smaller oil exporting nations) had been easing off its prior production restraint to fill in for expected declines in Iranian crude volumes following the U.S. exit from the Iranian nuclear deal last spring. OPEC production alone had risen by 1.4 million barrels per day from April through October despite declines in Iranian production. News reports in early November that the U.S. would grant temporary waivers to some large buyers of Iranian crude for six more months was a negative surprise to a market that had expected the opposite, a more stringent application of U.S. sanctions, further contributing to price weakness. The oil market was already quite concerned that the inventory reduction progress that had been made in the oil market in 2017 and the first half of 2018 could quickly be reversed by a combination of rising production and slowing demand growth, so these data points on U.S. and OPEC production and a flattening of Iranian exports only added to these concerns. "OPEC +" acknowledged these fears and the attendant risks and managed after much discussion and negotiation (too much in our opinion) in early December to commit to another round of production cuts beginning in January 2019 to help bring the market back into balance. Initially, the decision to cut production again was not favorable for oil prices. It took several weeks to see data on actual reductions in tanker loadings and export volumes, particularly loadings out of Saudi Arabia, to begin to stabilize the oil market. It also took nearly a month of data to see proof that production levels and inventories were declining. However, uncertainty and volatility in the oil market remain quite elevated. Production is only one side of the pricing equation as uncertainty regarding the economy and the demand outlook continue to be high and continue to create volatility in energy commodities and equities.

Baron Energy & Resources Fund (the "Fund") fell by 29.8% (Institutional Shares) during the quarter, which was more in line with the performance of indexes that are more weighted toward pure play oil & gas exploration and

Performance listed in the above table is net of annual operating expenses. Annual expense ratio for the Retail Shares and Institutional Shares as of December 31, 2017 was 1.66% and 1.42%, respectively, but the net annual expense ratio was 1.35% and 1.10% (net of the Adviser's fee waivers), respectively. 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 or call 1-800-99BARON.*

[1] The indexes are unmanaged. The S&P North American Natural Resources Sector Index measures the performance of U.S.-traded natural resources related stocks and the S&P 500 Index of 500 widely held large cap U.S. companies. The S&P 500 Energy Index comprises those companies included in the S&P 500 that are classified as members of the GICS® energy sector. The indexes and the Fund are with 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 redemptions of Fund shares.

[3] Not annualized.

production companies or oilfield service & equipment stocks. Sub-industry indexes such as the S&P 500 Oil & Gas Exploration & Production Index or the S&P 500 Oil & Gas Equipment & Services Index lost 30.6% and 38.0%, respectively, during the fourth quarter. Our Fund has historically steered toward these sub-indexes of the energy market and steered away from the integrated oils such as Exxon Mobil Corp. and Chevron Corp., which combined comprised a substantial part of both the S&P 500 Energy Index (44.4%) and the S&P North American Natural Resources Sector Index (14.9%) at year end. Integrated oils such as these stocks generally outperform in down markets and did just that in the fourth quarter, with Exxon's stock price falling 19.0% and Chevron's declining by only 10.2%, both of which outperformed these benchmarks as well as indexes comprised of more pure play oil & gas exploration & production or oilfield service & equipment and drilling companies.

### Table II.
Top contributors to performance for the quarter ended December 31, 2018

| | Year Acquired | Percent Impact |
|---|---|---|
| Tesla, Inc. | 2015 | 1.31% |
| Andeavor | 2017 | 0.14 |

**Tesla, Inc.** designs, manufactures, and sells fully electric vehicles, solar products, and energy storage solutions. Shares appreciated on third quarter results that exceeded investor expectations, including a margin profile and cash generation that eased investor fears of liquidity risks. Tesla also expressed confidence it can support growth with internally generated cash flow. Tesla is expanding Model 3 activity to new markets, including acceleration of production facilities in China and deliveries in China and Europe as soon as early 2019.

**Andeavor** is a U.S. refining company with midstream projects on the West Coast and in the Permian Basin in West Texas and access to cheap crude through its refiners. Marathon Petroleum's acquisition of Andeavor closed on October 1. Shares of Andeavor increased for the period held prior to the close of the acquisition.

### Table III.
Top detractors from performance for the quarter ended December 31, 2018

| | Year Acquired | Percent Impact |
|---|---|---|
| Concho Resources, Inc. | 2012 | –4.26% |
| Parsley Energy, Inc. | 2014 | –3.94 |
| Encana Corp. | 2016 | –3.61 |
| WPX Energy, Inc. | 2016 | –1.74 |
| Halliburton Co. | 2012 | –1.41 |

**Concho Resources, Inc.** is an independent exploration and production ("E&P") company focused on the Permian Basin in West Texas and New Mexico. Concho's shares fell following sharp decline in oil prices as investors became increasingly concerned about its ability to grow volumes without outspending cash flow in 2019. Concho continues to be one of the best run E&P companies, and we expect the company to deliver its multi-year production growth plans while focusing on free cash flow generation, returning cash to shareholders, and improving capital efficiency.

**Parsley Energy, Inc.** is an independent E&P company focused on the Permian Basin in West Texas. Shares fell following a sharp decline in oil prices and concerns over Parsley's cash flow outspend next year. Shares were sold for tax loss reasons.

**Encana Corp.** is a Canadian-based E&P company with primary operations in Western Canada and Texas. Shares declined after the company announced the acquisition of Newfield Exploration, which has limited geographic overlap with Encana's core position in the U.S. Shares were sold for tax loss reasons.

**WPX Energy, Inc.** is an independent E&P company primarily focused on the Bakken Basin in North Dakota and the Delaware Basin in West Texas. Shares fell following sharp declines in oil prices and concerns over WPX's cash flow outspend next year. Shares were sold for tax loss reasons.

**Halliburton Co.** is a leading provider of oilfield services and equipment to the global energy industry. Shares declined after the company guided down earnings expectations for the fourth quarter due to softness in U.S. pressure pumping demand caused by a combination of budget exhaustion and Permian takeaway constraints. Although we think the softness is demand is transitory, we don't expect activity to recover until much later in 2019 given E&P capital budget constraints driven by lower oil prices. All of the shares we owned were sold.

## Portfolio Structure

### Table IV.
Fund investments in GICS sub-industries as of December 31, 2018

| | Percent of Net Assets |
|---|---|
| Renewable Energy-Related (Tesla & TPI Composites) | 19.6% |
| Oil & Gas Exploration & Production | 17.7 |
| Oil & Gas Storage & Transportation | 14.7 |
| Oil & Gas Equipment & Services | 8.9 |
| Oil & Gas Refining & Marketing | 7.1 |
| IT-Related (Aspen Technology) | 6.0 |
| Integrated Oil & Gas | 3.4 |
| Cash and Cash Equivalents | 22.6 |
| | 100.0% |

### Table V.
Top 10 holdings as of December 31, 2018

| | Year Acquired | Market Cap When Acquired (billions) | Quarter End Market Cap (billions) | Amount (millions) | Percent of Net Assets |
|---|---|---|---|---|---|
| Tesla, Inc. | 2015 | $30.3 | $57.2 | $4.7 | 13.8% |
| Concho Resources, Inc. | 2012 | 10.1 | 20.6 | 4.3 | 12.6 |
| Aspen Technology, Inc. | 2015 | 3.3 | 5.8 | 2.0 | 6.0 |
| TPI Composites, Inc. | 2017 | 0.5 | 0.8 | 2.0 | 5.8 |
| Golar LNG Ltd. | 2012 | 3.5 | 2.2 | 1.9 | 5.6 |
| Gravity Oilfield Services Inc. | 2017 | – | – | 1.6 | 4.6 |
| Marathon Petroleum Corporation | 2018 | 59.7 | 40.8 | 1.5 | 4.5 |
| Cactus, Inc. | 2018 | 0.5 | 2.1 | 1.4 | 4.3 |
| Petróleo Brasileiro S.A. – Petrobras | 2018 | 66.1 | 80.9 | 1.1 | 3.4 |
| Magnolia Oil & Gas Corp. | 2018 | 3.0 | 2.8 | 1.0 | 2.8 |

## Recent Activity

**Table VI.**
**Top net purchases for the quarter ended December 31, 2018**

| | Quarter End Market Cap (billions) | Amount Purchased (millions) |
|---|---|---|
| Anadarko Petroleum Corporation | 21.7 | 0.2 |

**Table VII.**
**Top net sales for the quarter ended December 31, 2018**

| | Amount Sold (millions) |
|---|---|
| Parsley Energy, Inc. | $2.1 |
| Encana Corp. | 1.4 |
| Halliburton Co. | 1.2 |
| WPX Energy, Inc. | 1.0 |
| Siemens Gamesa Renewable Energy, S.A. | 0.7 |

## Outlook

The oil market and the direction of the oil price continue to be the dominant factors driving share price performance across the energy landscape and currently, the oil market remains quite volatile as investors find themselves dealing with a myriad of risks and uncertainties pertaining to both the demand and supply side of the oil market. On the demand side, a combination of macroeconomic and geopolitical factors has created greater uncertainty on the demand growth trajectory than in recent years. While current estimates for 2019 from forecasters at the International Energy Agency (IEA) and the Energy Information Administration (EIA) still show robust demand growth of between 1.4 million barrels per day and 1.55 million barrels per day, both of which are above the estimate for demand growth in 2018, there has been significant growing doubt among investors that these levels of demand can be achieved in the face of slowing economic growth across the U.S., Europe, and Asia. The fears on the growth side have been exacerbated by a combination of political factors such as the ongoing trade negotiations (i.e., tariff war) between the U.S. and China, the tightening of monetary policy in the U.S., and the impact of a rising dollar on emerging market economies. We believe that the growing fear in the fourth quarter that the global economy was slowing faster than expected and could potentially tip into recession was perhaps a more significant contributor to oil price weakness than any of the data points or concerns that emerged on the supply side of the market. While markets appear to have bounced back in the early part of 2019, many of the aforementioned factors remain unresolved and could easily bring back these concerns and add to volatility in the oil market. Therefore, it is our view that the outlook for the oil and the overall energy market this year will continue to hinge more on the factors that drive demand than those that are important to supply.

It is not that the outlook for oil supply growth is not important, it remains very important, but it is easier for the industry to manage supply than demand and the data on supply tends to be more accurate and more real time. In terms of the supply outlook for the coming year, we expect that supply will not have a problem keeping up with demand growth. While "OPEC +" cuts announced in December and taking effect this month should help to balance the market and prevent inventories from rising further, risks remain regarding the cohesion of the group. In addition, the politics surrounding OPEC and Russia remain complicated by factors such as President Trump's tweets, ongoing investigations involving Russia, conflicts that are still raging across the Middle East, and the U.S. Congress's interest in pursuing legislation against either OPEC or Saudi Arabia. The geopolitics of oil are always complicated, but the current slate of issues seems particularly full. Based on current information, we anticipate the current round of production restraint will be effective in limiting supply growth from "OPEC +" for at least the first half of the year, although the cuts could begin to be unwound in the second half of 2019 if demand forecasts prove to be correct and the "call on OPEC" is higher in the second half of 2019 than the first half. In contrast to "OPEC +" we continue to expect that U.S. oil growth will lead the world again in 2019, with most of that growth coming from unconventional reservoirs with leadership from the Permian Basin. However, much of the sequential growth in oil production in the U.S. could be more weighted to the back half of the year due to a recent slowdown in completion activity and the fact that there is limited spare pipeline and other infrastructure capacity in the first half. These constraints begin to ease with significant new pipeline capacity starting up in the third and fourth quarters of 2019, which could prompt an increase in well completion activity starting around midyear.

In addition, the fourth quarter plunge in oil prices is causing oil producers in the U.S. and around the world to reconsider investment levels for 2019, which are now likely to be lower than would have been the case had oil prices (WTI) held above $60 per barrel. However, we and other investors also continue to put significant pressure on oil producing companies to focus on living within cash flow, improving returns on capital and placing less emphasis on growth as the primary outcome. In our view, growth should be a byproduct of prudent investment and balance sheet management. In addition to those producers that are simply seeking to live within cash flow, there is a growing cadre of producers that are turning more attention to generating free cash flow and returning much of that free cash flow in the form of dividends and stock buybacks. Several companies either announced initial dividends in the second half of 2018 or announced increases to dividends and cash return initiatives. We think this is a positive step for the industry and, while it should result in lower production growth rates and perhaps lower peak earnings power for oilfield services & equipment companies, ultimately, we think this creates a more viable and investible industry.

The outlook for 2019 for the renewable energy industry appears to be solid, with growth in the installed base for wind and solar increasing modestly from 2018 levels according to forecasts from Bloomberg New Energy Finance ("BNEF"). However, while the growth rate in the installed base is pretty consistent globally, it is expected to rise faster in the U.S. According to BNEF's latest forecasts, new global wind installations are expected to be 23% higher in 2019 compared to estimated growth of 14% in 2018 and solar installation growth is estimated at 24% compared to a 5% decline in 2018's level of new installations. In the past several quarters, we have seen a pickup in order backlogs for turbines, wind blades, and solar panels for a number of publicly traded equipment suppliers, which helps corroborate the BNEF forecasts for improved volume growth. Pricing and margins in the renewable energy industry remain a challenge as competition for new projects remains fierce around the world.

# Baron Energy and Resources Fund

Thank you for investing in the Baron Energy & Resources Fund.

Sincerely,

James Stone
Portfolio Manager

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**Risks:** 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 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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