Dear Baron Real Estate Fund Shareholder:

Performance

We are pleased to report that the Baron Real Estate Fund (the "Fund") generated strong performance for the nine months ended September 30, 2019.

During this period, the Fund gained 30.17% (Institutional Shares), exceeding its primary benchmark index, the MSCI USA IMI Extended Real Estate Index (the "MSCI Real Estate Index"), which rose 26.53%. Moreover, the Fund's 30.17% nine-month gain also exceeded that of the MSCI US REIT Index, which appreciated 25.71%, and that of the S&P 500 Index, which increased 20.55%.

In the most recent quarter ended September 30, 2019, the Fund generated a 4.87% return, modestly underperforming the MSCI Real Estate Index, which gained 5.52%. The MSCI US REIT Index, which gained 7.38%, benefited disproportionately from the continued decline in interest rates. The U.S. 10-Year Treasury yield declined from 2.00% on June 30, 2019 to 1.68% on September 30, 2019. This decline resulted in strong investor appetite for dividend yielding securities such as REITs. The Fund's 4.87% return during the most recent three-month period outperformed a broader measure of the stock market, the S&P 500 Index, which gained 1.70%.

JEFFREY KOLITCH

PORTFOLIO MANAGER

Retail Shares: BREFX
Institutional Shares: BREIX
R6 Shares: BREUX

Table I.
Performance
Annualized for periods ended September 30, 2019

	Baron Real Estate Fund Retail Shares[1,2]	Baron Real Estate Fund Institutional Shares[1,2]	MSCI USA IMI Extended Real Estate Index[1]	MSCI US REIT Index[1]	S&P 500 Index[1]
Three Months[3]	4.79%	4.87%	5.52%	7.38%	1.70%
Nine Months[3]	29.92%	30.17%	26.53%	25.71%	20.55%
One Year	8.74%	9.01%	11.64%	16.84%	4.25%
Three Years	9.82%	10.10%	10.14%	5.91%	13.39%
Five Years	6.23%	6.50%	10.21%	8.72%	10.84%
Since Inception (December 31, 2009) (Annualized)	13.14%	13.42%	12.55%	10.99%	12.92%
Since Inception (December 31, 2009) (Cumulative)[3]	233.20%	241.44%	216.78%	176.31%	227.00%

Strong year-to-date performance for the Fund is due to several positive factors. These include:

- Business results for most commercial and residential real estate companies have been positive.
- Management commentary regarding expectations for the balance of 2019 has largely been constructive.
- The U.S. economy is growing at a moderate pace following rapid growth in 2018, which was largely propelled by fiscal stimulus, including broad-based tax cuts.
- Interest rates, which spiked in 2018 and became a headwind for equities, have turned much lower this year and have become a tailwind. For example, the U.S. 10-year Treasury yield, which peaked at 3.23% in October 2018, declined by approximately 50% in the last 12 months to 1.68% as of September 30, 2019!
- The 30-year fixed mortgage rate, which peaked at 4.94% in November 2018, declined by 145 basis points to 3.49% in September 2019, providing a needed boost to the U.S. housing market.
- Central banks globally have pivoted to a more dovish stance. The Federal Reserve cut interest rates by 25 basis points in July 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, 2018 was 1.32% and 1.06%, 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 reimburses certain Baron Fund expenses pursuant to a contract expiring on August 29, 2030, unless renewed for another 11-year term 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.*

The Fund's historical performance was impacted by gains from IPOs and/or secondary offerings, and 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.

1 The indexes are unmanaged. The index performance is not Fund performance; one cannot invest directly into an index. 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 MSCI US REIT Index is a free float-adjusted market capitalization index that measures the performance of all equity REITs in the US equity market, except for specialty equity REITs that do not generate a majority of their revenue and income from real estate rental and leasing operations. The S&P 500 Index measures the performance of 500 widely held large cap U.S. companies. 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.

September. This should provide additional stimulus for the economy, including real estate, and should benefit the stock market.
- Inflation remains at modest levels.
- The stock valuations of many companies are reasonable and, in some cases, cheap.
- Corporate takeovers picked up, and there is anticipation of robust M&A activity in the months ahead.

Looking forward, we continue to expect the prospects for the market, real estate, and the Fund to remain positive. Please see the "Outlook" section at the end of this letter for our forward-looking views for the Fund.

Table II.
Top contributors to performance for the quarter ended September 30, 2019

	Quarter End Market Cap (billions)	Percent Impact
D.R. Horton, Inc.	$19.5	0.77%
Equinix, Inc.	48.9	0.76
Brookfield Asset Management, Inc.	52.8	0.42
Trex Company, Inc.	5.3	0.41
Americold Realty Trust	7.1	0.39

In 2019, the homebuilding market has been a bright spot in the U.S. economy. Home purchases have reaccelerated in the last few months primarily because of the improvement in home affordability, partly aided by the sharp decline in mortgage rates to only 3.5% and the moderation in home price appreciation.

The Fund's largest homebuilder investment is in **D.R. Horton, Inc.**, the number one homebuilder by volume in the U.S. In the most recent quarter, shares of D.R. Horton gained 22% due to solid new home order growth, reduced home price incentives, the return of modest pricing power, and an improvement in profitability margins.

We remain bullish about the long-term prospects for D.R. Horton primarily due to two key considerations:

First, we believe the company is positioned to perform well given its status as the largest and lowest-cost producer in the entry-level home segment for first-time buyers and baby boomers looking for an affordable home. In the last 12 months, approximately 70% of D.R. Horton's home sales were for prices less than $300,000, thereby enabling the company to satisfy the home affordability constraints of many potential home buyers.

Second, we are enthusiastic about D.R. Horton's continued transition to a stronger and more "asset-light" balance sheet by outsourcing its land development spending needs to third-party developers such as **Forestar Group Inc.** (another Fund holding). Ultimately, D.R. Horton's transition to a less capital-intensive business should lead to stronger cash flow generation, lower debt levels, an ability to pursue more share repurchases and/or other investment opportunities, and a higher-valuation multiple.

NVR, Inc., a homebuilder with a 100% "asset-light" strategy that avoids the financial requirements and risks associated with direct land ownership and development, is valued at a significant premium to every other homebuilder, including D.R. Horton. We expect that the valuation disparity between D.R. Horton and NVR will close over time as D.R. Horton executes on its own "asset-light" strategy.

The shares of **Equinix, Inc.**, the largest global data center company in the world and a long-term top holding of the Fund, increased 15% in the third quarter. Key highlights from recent quarterly results include:

- Strong business momentum: the company reported its second highest quarterly new booking activity in its history, and management expressed its expectation for sustained strength in new business demand.
- Continued improvement in its balance sheet: Equinix received its second investment grade rating, which should lead to lower debt financing rates, broader investment appeal for its shares, and, perhaps, a higher-valuation multiple for the company.
- $1 billion partnership with the Government of Singapore: Equinix announced a $1 billion joint venture partnership to develop and operate data centers in Europe with one of the world's largest sovereign wealth funds, GIC Private Limited (formerly, the Government of Singapore Corporation). Management anticipates additional partnership agreements that should support Equinix's global growth ambitions.

In addition to the key highlights noted above, we remain bullish on the long-term growth prospects for Equinix because we believe the company is well positioned to benefit from the powerful secular demand prospects that we have discussed in detail in prior letters: strong growth in information technology ("IT") outsourcing; increased cloud computing adoption; and, powerful data demand trends.

The shares of **Brookfield Asset Management, Inc.** increased 11% in the most recent quarter. Brookfield is a leading alternative asset manager, focused on investing in high-quality assets that tend to generate predictable and growing cash flows. Brookfield has investments in more than 30 countries and total assets of over $500 billion. The company's investments include one of the largest real estate portfolios in the world, an industry-leading infrastructure business, one of the largest renewable power businesses, and a rapidly expanding private equity business.

We first acquired shares in Brookfield shortly after we launched the Fund in December 2009, and Brookfield was the Fund's largest holding on March 31, 2010. Fast forward almost 10 years to September 30, 2019, and Brookfield remains one of the largest holdings in the Fund. Although its shares have appreciated by 317% since our first purchase which compared favorably to the 212%, 177%, and 221% gains in the MSCI Real Estate Index, MSCI US REIT Index, and the S&P 500 Index, respectively, we remain even more bullish about Brookfield's prospects for the next 10 years!

Our enduring enthusiasm for Brookfield's long-term prospects is due to four key considerations:

1. Secular growth opportunity for "alternative" assets

Institutional allocations to "alternative" investment assets such as real estate, infrastructure, and private equity, are expected to grow dramatically in the years ahead because of two key considerations:

First, interest rates around the world are at or near all-time lows. In the U.S., for example, the 10-Year Treasury yield has declined to only 1.68% versus a long-term average of 5.8%. 10-year interest rates in the other major markets for capital – Japan and Europe – are negative! In fact, globally, approximately *$15 trillion* in government debt now has *negative yields*!

Consequently, traditional fixed income investment options are unlikely to generate sufficient returns for large institutional investors such as pension funds, sovereign wealth funds, insurance companies, and endowments.

Second, allocations to “alternative” investments in real estate, infrastructure, and private equity are increasing at an accelerating rate as institutions shift a large portion of their capital away from fixed income investment options (and to a lesser extent equity investments) because “alternatives” are expected to generate attractive relative and absolute returns with less volatility.

At its annual investor day presentation in September, the management of Brookfield highlighted that allocations to “alternatives” were only 5% in 2000 (versus 95% allocated to equity and fixed income investment options), had grown to 15% in 2016, and jumped to 25% in 2018. Management estimates that if interest rates remain low, alternative allocations may increase to more than 60% by 2030, resulting in an incremental *$25 trillion* dollars allocated to alternative investments!

2. Brookfield is well positioned to increase its market share of the growing pool of “alternative” assets

Institutional investors are consolidating the number of asset managers they invest with. We believe Brookfield is poised to remain a major beneficiary of this consolidation trend not only because of its strong long-term investment results, but also attributable to three key competitive advantages:

(i) Scale advantages: Brookfield’s large-scale and strong balance sheet allow it to be involved in large multi-billion dollar transactions where the competitive buyer pool is relatively narrow.

(ii) Global capabilities: The company’s presence in over 30 countries affords Brookfield the ability to cast a wide net for sourcing potential acquisitions and pursue opportunities in geographic markets where valuations are most attractive.

(iii) Operating expertise: Brookfield has a team of more than 100,000 operating employees in over 30 countries–a key differentiator versus many of its asset management peers. Brookfield’s financial and operating capabilities are, at times, the “tie breaker” that results in the company being chosen to participate in complex transactions across multiple geographies that require a heavy operating component.

3. Attractive valuation and strong future growth prospects

At its recent share price of $51, management estimates its stock price is valued at a 25% discount to its assessment of intrinsic value. We agree with management that the company’s current valuation discount provides a “margin of safety” and may shrink over time if management continues to execute on its business plan.

We believe the future growth prospects for Brookfield and its share price remain compelling:

- In the last 20 years, Brookfield’s share price has increased, on average, an impressive 19% annually.
- In the next five years, management believes it can grow its share price, on average, 22% annually from $51 per share to $141 per share!

  According to management, the building blocks to achieving its $141 per share five-year share price target include growing the company’s fee-bearing capital from $227 billion in 2019 to $400 billion by 2024 (12% CAGR), growing fee-related earnings, on average, 16% annually, increasing cash flows that will provide the ability to return cash to shareholders through stock buybacks and dividends, and shrinking the company’s valuation discount.

  Management has a strong track record of under-promising and over-delivering, and we believe it will do so again in the years ahead.

4. Excellent management team with interests aligned with shareholders

CEO Bruce Flatt and his deep leadership team are on our “short list” of most impressive management teams. They are, in our view, a highly talented group of executives who are astute allocators of capital and excellent operators of businesses. Management’s interests are aligned with its shareholders given that officers and directors own approximately 20% of the company.

We agree with CEO Bruce Flatt’s comment at Brookfield’s annual investor day in September when he said, “If we can execute, the next 10 years are set up to be better than the last 10!”

The shares of **Trex Company, Inc.**, the largest manufacturer of wood-alternative (composite) outdoor decking and railing in the U.S., gained 27% in the most recent quarter due to strong quarterly business results and management’s optimistic tone regarding the potential for an acceleration in sales and earnings growth in 2020.

We remain optimistic about the long-term growth prospects for Trex, because we expect composite decking will continue to increase its share of the decking market due to its superior performance and lifetime cost advantages relative to wood decking. We expect the company to continue to increase its industry-leading 40% market share in the years ahead due to its brand leadership and broad array of composite decking products. We believe Trex should benefit from the ongoing recovery in U.S. new and existing home sales and the growing desire by consumers for outdoor living spaces as 90% of Trex’s sales are generated from the residential real estate market. Management has introduced a broader array of composite decking products (i.e., new lower price point decking products that target the do-it-yourself consumer), commercial products (railing), and expanded into international markets (currently less than 10% of sales), all of which should enhance growth in the years ahead.

The shares of **Americold Realty Trust** continued to perform well in the most recent quarter due to solid business results and the expectation for a continuation of strong long-term business prospects. The company is the only REIT that focuses on owning and operating temperature-controlled warehouses. It has the largest portfolio of these warehouses in the U.S. and globally. We think Americold is well positioned to deliver superior growth relative to most REITs due to strong demand trends, limited supply, and opportunities to improve occupancy and rents in its current portfolio.

We continue to anticipate that Americold will bolster its growth by developing additional warehouses and by making acquisitions of other temperature-controlled warehouses.

Despite Americold’s share price more than doubling from $16 to $38 (ex-dividends) since its initial public offering in January 2018, we continue to believe the shares remain attractively valued relative to most REITs and the private market. We remain bullish about the long-term prospects for the company and its shares.

Baron Real Estate Fund

Table III.
Top detractors from performance for the quarter ended September 30, 2019

	Quarter End Market Cap (billions)	Percent Impact
Royal Caribbean Cruises Ltd.	$22.7	–0.39%
Boyd Gaming Corporation	2.7	–0.35
Norwegian Cruise Line Holdings, Ltd.	11.2	–0.16
Penn National Gaming, Inc.	2.2	–0.10
MGM Resorts International	14.5	–0.10

In the most recent quarter, market concerns regarding a global slowdown in economic growth weighed on the share prices of a portion of the Fund's holdings that are cyclically and consumer oriented–most notably, cruise lines (**Royal Caribbean Cruises Ltd.** and **Norwegian Cruise Line Holdings, Ltd.**) and casino and gaming companies (**Boyd Gaming Corporation**, **Penn National Gaming, Inc.**, and **MGM Resorts International**).

Our research, however, indicates that business conditions are prospectively stable, and the consumer remains in solid shape (e.g., unemployment is low, wage growth has picked up, mortgage rates have declined, and consumer sentiment measures are solid). Accordingly, we believe concerns regarding the economic growth outlook and the possibility that consumer spending may moderate are worse than the reality.

At current share prices, the valuations of many of the Fund' most cyclical real estate companies are, in our opinion, compelling.

Cruise Lines

In addition to concerns about the possibility that consumer-related demand may slow in the year ahead, the shares of cruise line operators, Norwegian and Royal Caribbean, have also been pressured due to other factors that include new travel regulations, which took effect on June 5 and eliminated the ability of cruise lines to offer cruises to Cuba; hurricane Dorian, which slowed cruise activity in the Caribbean; and higher oil prices.

At this stage, we believe these worries are largely reflected in the share prices. Both Norwegian and Royal Caribbean historically have traded at an average multiple of 13 times forward-year earnings. Currently, both Norwegian and Royal Caribbean are valued at only 9.5 times 2020 estimated earnings, even though both companies may grow earnings per share at a double-digit rate in 2020!

Casino and Gaming Companies

We believe the risk-reward prospects for the Fund's casino and gaming companies are favorable. The shares of these companies have generally lagged due to macro concerns about the possibility of a U.S. recession in 2020 and a corresponding slowdown in consumer spending. Unfavorable weather in the second quarter and for a portion of the third quarter likely weighed on shares. Current business conditions do not portend a notable slowdown in business activity, even though the share prices have, in our opinion, largely priced in a recession!

Boyd Gaming Corporation: With Boyd's shares trading at only 8.0 times 2019 estimated cash flow (EBITDA) and with a 14% free cash flow yield, we think the shares are highly compelling in large part because the company owns the real estate at 25 of its 29 properties. In our opinion, Boyd's owned real estate would be valued at a significant premium to its public market price in the private market.

Penn National Gaming, Inc.: At its recent price of only $18.50 per share, with a 2019 estimated cash flow multiple of only 5.9 times EBITDA, and the company's attractive 18% free cash flow yield, we believe Penn's valuation is attractive. In our view, Penn's high free cash flow generation, management's focus on deleveraging its balance sheet, and the possibility of strategic initiatives to drive shareholder value (perhaps the sale of owned real estate) are not reflected in Penn's share price.

MGM Resorts International: We remain optimistic about MGM's potential for share price appreciation. The company's domestic real estate assets are trading at a valuation of less than 8 times 2020 estimated cash flow–much cheaper than its casino and gaming peers. MGM offers an appealing combination of high-quality real estate assets, a leading presence in Las Vegas (one of the stronger real estate markets in the U.S.), a solid growth outlook, dividend growth prospects, and improving free cash flow. The company expects to generate free cash flow of $4.5 billion to $5.0 billion between 2018 and 2020. MGM has earmarked $2 billion for share repurchases, which at its recently depressed price of only $27.50 per share, would equate to buying back approximately 14% of the company.

Portfolio Structure

Since the launch of the Fund in December 2009, we have maintained that our philosophy of structuring a more inclusive and unique real estate fund – one that includes REITs, but also includes other diversified real estate-related categories, is a compelling long-term strategy. We continue to believe that the Fund is complementary to our Baron Real Estate Income Fund and most other REIT funds.

Since inception almost 10 years ago, the Fund has increased 13.42% annualized, which compares favorably to the MSCI US REIT Index which has gained 10.99% annualized.

The Fund's portfolio structure and strategy are as follows:

1. Real Estate-Related Categories

   The Baron Real Estate Fund currently has investments in REITs, plus eight additional real estate-related categories. Our percentage allocations to these categories vary, and they are based on our research and assessment of opportunities in each category (see Table IV below).

2. REITs and non-REITs

   Currently, the Fund has 29.3% of its net assets invested in REITs, 69.8% in additional real estate-related categories, and 0.9% in cash. We are optimistic about the prospects for both the Fund's REITs and our real estate-related investments. Presently, we believe that some of the Fund's other real estate categories offer superior return potential than most REITs, because of their discounted share prices and greater growth prospects.

3. Commercial and Residential Real Estate Categories

   The Fund continues to invest in both commercial and residential real estate-related companies.

   In addition to REITs, residential-related companies that the Fund evaluates for investment include homebuilders, building product and services companies, land developers, construction material companies, home centers, and senior housing operators.

In the first nine months of 2019, we have spent considerable time meeting with residential-related companies. Our research leads us to believe that the 2018 housing market slowdown only represented a pause in what should continue to be a multi-year housing recovery.

On September 30, 2019, residential-related real estate companies represented approximately 25% of the Fund's net assets (15.5% building products/services companies and 9.7% homebuilding and land development companies). For our more detailed housing-related thoughts, please see the "Top Net Purchases" section later in this letter.

4. Exposure to the U.S. Consumer and Cyclical Growth

We believe the unusual and favorable current combination of the *"four 3's"* bodes well for the U.S. consumer and the Fund's consumer-related real estate investments.

The "four 3's" refer to the recently reported 3.5% unemployment rate (a 50-year low!), 3% wage growth, greater than 3% home price appreciation (important given that home purchases are typically the largest investment for a consumer), and historically low 3.5% 30-year mortgage rates. In our opinion, these consumer tailwinds are a clear positive for U.S. economic growth and consumer spending prospects.

We continue to invest in real estate-related categories that should perform well if the "four 3's" persist. These real estate categories include homebuilders and land developers (9.7% of the Fund's assets), building product and services companies (15.5%), casino and gaming companies (11.8%), cruise lines (7.5%), vacation timeshare companies (2.0%), and hotels (0.4%). In our opinion, the valuations of many of these companies are compelling.

5. Emphasis on Real Estate Secular and Megatrend Real Estate Growth Companies

The Fund continues to prioritize real estate categories that we believe are positioned to benefit from durable megatrends and secular growth opportunities. These specialized real estate categories include data center companies, wireless tower companies, and industrial REITs that, in our view, are well positioned to benefit for several years from the technological revolution in cloud computing, the internet, artificial intelligence, autonomous vehicles, mobile data, cell phones, and wireless infrastructure. As of September 30, 2019, 19.1% of the Fund's net assets were invested in data centers (13.9%), wireless towers (3.2%), and industrial REITs (2.0%).

6. Number of Fund Holdings

As of September 30, 2019, the Fund was invested in 41 companies. Our 10 largest holdings represented 46.8% of the Fund. Our 20 largest holdings represented 72.1% of the Fund.

7. Market Capitalization

We continue to invest in companies of various market capitalizations. As of September 30, 2019, the median market capitalization of the Fund's investments was $11.2 billion. Companies with market capitalizations of less than $2.5 billion constitute only 6.9% of the Fund.

8. "Best-in-class" Companies*

We remain confident about the quality and strong long-term prospects of the Fund's holdings.

Table IV.
Fund investments in real estate-related categories as of September 30, 2019

		Percent of Net Assets
REITs		29.3%
Building Products/Services		15.5
Casinos & Gaming Operators		11.8
Real Estate Service Companies		10.1
Hotels & Leisure		9.9
Cruise Lines	7.5%	
Hotels & Timeshare/Leisure	2.4	
Homebuilders & Land Developers		9.7
Data Centers[1]		8.6
Real Estate Operating Companies		4.2
		99.1
Cash and Cash Equivalents		0.9
Total		100.0%

[1] Total would be 13.9% if included data center REITs Equinix, Inc. and QTS Realty Trust, Inc.

Table V.
Top 10 holdings as of September 30, 2019

	Quarter End Market Cap (billions)	Quarter End Investment Value (millions)	Percent of Net Assets
CBRE Group, Inc.	$17.8	$43.8	7.4%
Equinix, Inc.	48.9	30.3	5.1
Masco Corporation	12.1	28.6	4.9
MGM Resorts International	14.5	28.0	4.8
GDS Holdings Limited	5.8	28.0	4.8
D.R. Horton, Inc.	19.5	25.4	4.3
Norwegian Cruise Line Holdings, Ltd.	11.2	25.1	4.3
Brookfield Asset Management, Inc.	52.8	24.8	4.2
InterXion Holding N.V.	6.2	22.6	3.8
Royal Caribbean Cruises Ltd.	22.7	19.1	3.2

* Note that "best-in-class" represents our opinion and is not based on a third-party ranking. In our opinion, characteristics of a "best-in-class" real estate company are that it:

- Owns unique and well-located real estate assets in markets with high barriers to entry combined with attractive long-term demand demographics;
- Enjoys strong long-term growth prospects together with a leading competitive position;
- Maintains a conservative and liquid balance sheet; and, importantly,
- Employs an intelligent and motivated management team whose interests are closely aligned with shareholders.

Recent Activity

Table VI.
Top net purchases for the quarter ended September 30, 2019

	Quarter End Market Cap (billions)	Amount Purchased (millions)
Lowe's Companies, Inc.	$84.9	$8.7
Jones Lang LaSalle Incorporated	7.2	7.9
D.R. Horton, Inc.	19.5	5.9
Masco Corporation	12.1	4.2
Installed Building Products, Inc.	1.7	3.8

In the most recent quarter, we continued to increase the Fund's exposure to companies that we expect to benefit from the resumption of the recovery in the U.S. housing market.

We met with several homebuilders and other residential-related real estate companies, and we are encouraged by what we learned. Executives have cited that many of the factors that slowed home purchases and housing-related spending in 2018 have, in the last few months, improved. These include the significant decline in mortgage rates to only 3.5%, the moderation in home price appreciation, solid consumer sentiment, and strong job and wage growth. This has led to an acceleration in new home purchase order growth and a decline in home price incentives.

We are optimistic about the prospects for our most recent housing-related purchases. They include:

- **Lowe's Companies, Inc.** is the second largest home improvement center in the U.S. The company's most recent quarterly results demonstrated that Lowe's new senior management team continues to make meaningful progress improving its business operations and results. The company's U.S. same-store sales results exceeded those of **Home Depot, Inc.** (another Fund holding) for only the third time in nine years. We attribute Lowe's strong same-store sales results to a handful of recent initiatives that have improved product selection and customer service and convenience.

  We believe the company has opportunities to improve its gross margins. Lowe's has legacy pricing systems that have yet to sufficiently raise retail prices to offset the impact of product cost inflation. Management has begun to address the pricing issues, and it expects to launch a new price management system later this year.

  We believe the company has the potential for significant future profit improvement. Lowe's 9% operating profit margin (inclusive of the recent pricing issues) for 2019 compares to its medium-term margin target of 12% and Home Depot's current margin of 14.5%. If Lowe's achieves its medium-term margin target, it will generate significant increases in profit, which, when coupled with the company's large share repurchase program, should lead to accelerated future earnings per share growth. We believe that Lowe's stock has the potential to appreciate substantially as the company continues to make progress on its business transformation.

- **Masco Corporation** is a leading company of branded home improvement and building products. Following the company's planned divestitures of its cabinets and windows businesses, Masco will have dramatically reduced its exposure to the more cyclical new construction segment of residential real estate. The "new" Masco, which will primarily be a plumbing and decorative paints company, will have 90% exposure to repair and remodel spending, a segment of the residential real estate market that tends to be more resilient than the new construction segment, and therefore should garner a premium valuation.

  We believe Masco's shares could increase 15% annually over the next few years through a combination of double-digit earnings growth (fueled from organic growth, possible margin expansion, acquisitions, and share repurchases) <u>and</u> an expansion in the company's valuation multiple from 10 times EBITDA currently to 11 or 12 times EBITDA.

- **D.R. Horton, Inc.** is the largest homebuilder by volume in the U.S. We are optimistic about the long-term prospects for the company. Please see the "Top Contributors" section for our more detailed thoughts on the company.

- **Installed Building Products, Inc.** ("IBP") is one of the nation's largest insulation installers for the residential new construction market. It is also a diversified installer of complementary building products. IBP should be a prime beneficiary of growth in new home construction as approximately 77% of IBP's business is generated from new housing construction (67% new single-family and 10% new multi-family).

We believe the company has several opportunities for growth including:

(i) Expanding its 28% market share of new residential construction organically by growing its current business platform of services;

(ii) Acquiring other businesses – IBP has a successful track record of acquiring and integrating more than 140 companies, realizing cost savings, and enhancing the profitability of these acquired businesses; and

(iii) Broadening its residential and commercial building segments which currently represents only 17% of sales.

We expect business to improve in the second half of 2019, and we believe our investment in IBP has the potential to compound at 15% per year over the next few years.

In the most recent quarter, we began acquiring shares in **Jones Lang LaSalle Incorporated** ("JLL"). JLL is the second largest commercial real estate ("CRE") services company in the world. The largest CRE firm is **CBRE Group, Inc.**, a long-term holding in the Fund.

At a high level, we remain bullish on the commercial real estate brokerage category because of the secular growth trends of companies outsourcing their commercial real estate needs <u>and</u> the institutionalization of commercial real estate investing, both of which benefit the large global platforms of JLL and CBRE. More specifically:

1. A growing number of companies are increasingly looking to outsource their commercial real estate needs. JLL estimates that 80% of corporations are managing their real estate in-house, presenting a large growth opportunity. CBRE estimates that outsourcing has a market potential of approximately $140 billion. CBRE and JLL are far and away the top two players at the early stage of this rapidly expanding market. We believe the outsourcing businesses of both companies may grow revenues at a double-digit annual pace for several years.

2. Institutional ownership of commercial real estate continues to accelerate. JLL is well positioned to serve client needs given its array of capabilities in property management, appraisal and valuation services, and property brokerage services.

The commercial real estate industry remains highly fragmented and will, in our opinion, continue to consolidate. Customers tend to prefer commercial real estate companies that can provide a broad set of services. In our opinion, only two firms have the capability to provide the full array of real estate offerings on a global scale (CBRE and JLL).

We believe JLL is well positioned to capitalize on ample attractive acquisition opportunities in the years ahead given its global platform and strong balance sheet. The company boasts an investment grade balance sheet, its ratio of net debt-to-cash flow is only 1.0 times, and the company has adequate liquidity to support continued long-term growth.

In March 2019, JLL announced that it had reached an agreement to acquire HFF, Inc. ("HFF") for $2 billion. HFF is a leading U.S.-centric commercial real estate capital markets company with capabilities in debt and equity placement, loan servicing and sales, M&A, and investment advisory. We view this acquisition favorably and believe it strengthens JLL's overall business as its U.S. capital markets business had been a laggard in terms of market share against its largest peers, notably CBRE. The combination of JLL and HFF is highly complementary in terms of geographic and business line mix and should accelerate the growth and scale of JLL's U.S. capital markets business. Together, JLL and HFF will be able to provide deeper and enhanced capabilities for clients and more cross-selling business opportunities in other areas such as property and facilities management.

In the last few months, the shares of JLL have languished relative to its peers due to concerns about the price paid for HFF in what some surmise as the later stages of the commercial real estate cycle. We do not share these concerns and believe the HFF acquisition strengthens JLL's business. At its recent price of $133 per share, we believe JLL's shares are attractively valued at only 10 times our estimate of 2020 earnings per share versus its long-term historical average valuation of approximately 16 times per share.

Table VII.
Top net sales for the quarter ended September 30, 2019

	Quarter End Market Cap or Market Cap When Sold (billions)	Amount Sold (millions)
JBG SMITH Properties	$ 5.2	$7.0
Equinix, Inc.	48.9	6.2
China Tower Corporation Limited	42.0	6.2
Trex Company, Inc.	5.3	4.7
NEXTDC Limited	1.4	4.1

In the most recent quarter, we exited the Fund's investments in three companies.

We chose to exit **JBG SMITH Properties**, despite our favorable view of management and the long-term prospects for JBG, because business conditions remain challenging in a portion of the company's Northern Virginia sub-markets. At this stage, we believe other REITs offer superior return potential.

Following solid share price performance, we exited the Fund's investment in **China Tower Corporation Limited** because recent business results and management commentary have made us less confident in the outlook for the company's future growth and business prospects.

We exited the Fund's investment in **NEXTDC Limited**, an Australian data center company, due to ongoing operating issues. Nonetheless, we remain optimistic about the company's long-term growth prospects, and we may revisit the company in the future.

Following strong share price performance this year, we modestly trimmed our investments in data center company, **Equinix, Inc.**, and building products company, **Trex Company, Inc.** We remain bullish about both companies' long-term prospects.

Outlook

We are certainly mindful of the angst that looms over the market. There is a long list of unclear outcomes including economic growth prospects, the Fed's future actions on interest rates, the U.S.-China trade war, the 2020 U.S. presidential election, and various geopolitical and humanitarian crises.

We continue to believe, however, that the prospects for the equity market and the Baron Real Estate Fund remain attractive. We do not believe that the precursors for a sustained market correction are evident. We remain bullish.

The foundation for our constructive view is based on the following considerations:

1. *The U.S. economy appears to be "not too hot and not too cold".* We believe that economic growth is expanding moderately, without signs that a recession is on the horizon. This economic environment should, in our view, be a positive backdrop for stocks.

2. *Interest rates are likely to remain low.* Moderate U.S. economic growth and uncertainties abroad do not portend a rapid increase in interest rates. Additionally, central banks globally have pivoted to a more dovish stance. The Federal Reserve, for example, cut interest rates by 50 basis points in the third quarter, and additional rate cuts may be on the horizon. This should provide additional stimulus for the economy, including real estate, and should benefit the stock market.

3. *Inflation concerns seem well off in the horizon.* With no signs of a significant acceleration in wage and consumer price inflation, the Fed and the bond market are unlikely to be concerned. Further, lower gasoline and import prices should be a boon to U.S. consumers. We believe non-inflation growth should also bode well for equity returns.

4. *Investor sentiment is poor.* Investor sentiment appears to be overly pessimistic. In the cycle of stock market emotions, we believe that the best time to buy stocks to help generate maximum returns occurs when sentiment is poor, although we cannot guarantee this will be the case.

5. *Valuations are reasonable (and, in some cases, cheap).* In our opinion, equity valuations are now generally fair (the S&P 500 P/E is approximately 17 times forward earnings) and remain attractive versus bonds. We believe the valuations of numerous real estate companies, such as commercial real estate services, casino and gaming, timeshare, cruise lines, residential real estate-related, and certain REITs, are cheap relative to their historical valuations and future growth prospects.

6. *Additional reasons to be optimistic.* Business conditions are generally solid for our real estate-related companies. The outlook for housing is brighter. The U.S. banking system has improved dramatically and is now maintaining strong capital ratios. With large U.S. cash positions

and low-cost debt, corporate balance sheets are well positioned for M&A activity, capital expenditures, employment growth, stock buybacks, and dividend increases. There is a large pool of private equity investment capital poised for deployment. Jobs are being added. Credit spreads have narrowed. Mortgage rates have declined. We are not witnessing the wide-ranging forewarnings that typically signal the end of a business and/or real estate cycle such as spikes in economic growth, construction activity, interest rates and/or inflation, and the aggressive use of debt.

With these factors in place, we believe the equity market and real estate will continue to successfully climb a "wall of worry" and generate positive returns.

We continue to believe the Fund is composed of high quality real estate companies. The businesses that we continue to emphasize: (a) are well managed; (b) are market leaders; (c) own well-located real estate; (d) grow cash flow at a faster rate than most peers; and (e) possess quality balance sheets. We believe these special best-in-class companies should generate higher returns over the long term.

We have structured the Fund to capitalize on what we believe are compelling investment themes (as discussed above) and expect our portfolio companies to benefit from the ongoing health of the U.S. consumer (casino & gaming and cruise line companies), the rebound in the U.S. homebuilding market (homebuilders and building product and services companies), and the technology revolution (data center, wireless tower, and industrial REIT companies). We remain optimistic about the prospects for the Fund.

Thank you for your past and continuing support. I remain a major shareholder of the Baron Real Estate Fund, alongside you.

Sincerely,

Jeffrey Kolitch
Portfolio Manager

Investors should consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The prospectus and summary prospectus contain this and other information about the Funds. You may obtain them from its distributor, Baron Capital, Inc., by calling 1-800-99BARON or visiting www.BaronFunds.com. Please read them carefully before investing.

Risks: 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 cleanup; 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.

This report does not constitute an offer to sell or a solicitation of any offer to buy securities of Baron Real Estate Fund by anyone in any jurisdiction where it would be unlawful under the laws of that jurisdiction to make such an offer or solicitation.