DEAR BARON REAL ESTATE FUND SHAREHOLDER:

PERFORMANCE

The Baron Real Estate Fund (the "Fund") declined 2.76% (Institutional Shares) in the third quarter, underperforming its primary benchmark, the MSCI USA IMI Extended Real Estate Index (the "MSCI Real Estate Index"). Almost 60% of the Fund's underperformance in the quarter (and 50% of its year-to-date underperformance) was due to our building products and services investments, many of which have been positive contributors over time. Over the course of 2018, we have been identifying some headwinds for these businesses, particularly the slowdown in the U.S. housing market that began to pick up late in the second quarter, and we took action by continuing to reduce our exposure in the third quarter. Nevertheless, these actions and the positive performance of other segments of real estate were not enough to overcome the downdraft that impacted building products and services stocks this past quarter.

Table I.
Performance
Annualized for periods ended September 30, 2018

	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]	(2.84)%	(2.76)%	1.91%	0.78%	7.71%
Nine Months[3]	(7.08)%	(6.91)%	1.18%	1.32%	10.56%
One Year	1.84%	2.12%	7.10%	2.37%	17.91%
Three Years	7.89%	8.18%	11.13%	6.30%	17.31%
Five Years	7.77%	8.05%	10.47%	7.78%	13.95%
Since Inception (December 31, 2009) (Annualized)	13.65%	13.94%	12.66%	10.34%	13.96%
Since Inception (December 31, 2009) (Cumulative)[3]	206.40%	213.22%	183.75%	136.48%	213.66%

While we are disappointed in our absolute and relative results for the quarter (and year-to-date), our process has not changed. The fundamentals of many of the businesses we own remain strong, and we are taking advantage of opportunities to invest in and add to quality real estate companies, many of which are now trading at attractive valuations.

JEFFREY KOLITCH
PORTFOLIO MANAGER

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

We encourage you to read the "Portfolio Structure" section presented later in this letter. There, we discuss in detail the portfolio's structure, which we believe will help illuminate the challenges the Fund has faced in 2018. We also describe a few key strategic steps we have been undertaking regarding portfolio positioning and structure.

We also urge you to review our perspective on the outlook for real estate and the Fund in the "Outlook" section later in this letter.

Despite recent underperformance, we believe Fund performance will rebound and resume its outperformance just as it has in the past.

The Fund was launched almost nine years ago on December 31, 2009. The Fund's performance for the full 8-year period ended December 31, 2017 was quite strong, delivering a cumulative return of 236.46% (Institutional Shares), exceeding the cumulative returns of the MSCI Real Estate Index (180.44%), the MSCI U.S. REIT Index (133.40%), and the S&P 500 Index (183.69%). During this same 8-year period, the Fund's average annual return of 16.38% surpassed the average annual return of the MSCI Real Estate Index (13.76%), the MSCI U.S. REIT Index (11.18%), and the S&P 500 Index (13.92%).

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 1.32% 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 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 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.

During the Fund's 8-year performance from 2010 to 2017, there were some temporary periods when the Fund delivered only modest results. Yet, in each case during these eight years, the Fund rebounded by resuming its strong performance. The most recent example occurred in 2016 and 2017. In 2016, the Fund declined 1.75%, underperforming the MSCI Real Estate Index, which gained 8.24%, the MSCI U.S. REIT Index, which gained 7.14%, and the S&P 500 Index, which increased 11.96%. In 2017, however, the Baron Real Estate Fund resumed its outperformance by advancing 31.42%, significantly outperforming the MSCI Real Estate Index, which gained 18.04%, the MSCI US REIT Index, which increased only 3.74%, and the S&P 500 Index, which increased 21.83%.

Table II.
Top contributors to performance for the quarter ended September 30, 2018

	Quarter End Market Cap (billions)	Percent Impact
Royal Caribbean Cruises Ltd.	$27.2	0.46%
Norwegian Cruise Line Holdings, Ltd.	12.7	0.44
InterXion Holding N.V.	4.8	0.31
The Sherwin-Williams Company	42.5	0.27
Brookfield Asset Management, Inc.	44.2	0.26

The shares of cruise line operators **Royal Caribbean Cruises Ltd.** and **Norwegian Cruise Line Holdings, Ltd.** each gained more than 20% in the most recent quarter. Both companies reported strong second quarter business results and cited their expectations for continued strength in cruise demand. Both companies are benefiting from positive consumer sentiment, particularly the North American consumer. Cruises are being booked in all core markets, including the Caribbean and Europe. Further, early indications suggest that business results in 2019 will also be strong given that consumers have been booking 2019 cruises at an earlier and faster rate than in previous periods.

Cruise line stocks historically have traded in a range of 10-to-20 times earnings (average multiple of approximately 15 times earnings). Currently, Norwegian trades at only 8.7 times its 2019 estimated earnings and Royal Caribbean trades at only 10.6 times its 2019 estimated earnings. We expect both companies to generate an average earnings growth of approximately 15% per year between 2018 and 2020. In our judgment, the valuations of both companies are attractive.

We also maintain our longer-term positive view of the total cruise line industry for the following reasons:

(a) favorable industry configuration wherein the three largest cruise line companies (Royal, Norwegian, and Carnival Cruise Lines) constitute approximately 80% of the industry;
(b) manageable new ship additions;
(c) millennials have become a rapidly growing and important segment of the cruise industry;
(d) high barriers to entry given that a new ship typically costs between $800 million to $1 billion;
(e) rational pricing strategies; and
(f) emerging new destination growth opportunities (e.g., Cuba).

The shares of **InterXion Holding N.V.**, a European-centric data center company, continued to perform well in the third quarter. The company delivered solid second quarter business results as it has consistently done since we began acquiring its stock in late 2015. We are encouraged by management's September announcement of new expansion projects in five markets across its European footprint. This latest announcement, in conjunction with a similar expansion announcement earlier in 2018, provides strong visibility into future cash flow growth. We are big fans of CEO David Ruberg and his management team, and we remain bullish about the company's prospects.

In the most recent quarter, the shares of **The Sherwin-Williams Company** gained 11.7% following solid second quarter business results. The company is a global leader in the manufacturing, development, distribution, and sale of paint, coatings, and related products to professional, industrial, commercial, and retail customers. Its well-known brands include Sherwin-Williams, Dutch Boy, Krylon, Minwax, Thompson's Water Seal, and Valspar.

Sherwin-Williams products are sold exclusively through more than 4,100 company-operated stores and facilities, while the company's other brands are sold through leading mass merchandisers, home centers, independent paint dealers, hardware stores, automotive retailers, and industrial distributors.

We believe Sherwin-Williams is an attractive long-term investment opportunity because:

1. Paint/coatings tend to possess compelling business advantages including pricing power, high margins, and low risk of sales erosion from e-commerce competition.
2. Sherwin-Williams benefits from several competitive advantages. It maintains a leading market share position in North America of approximately 40%, far greater than its closest competitor. The company benefits from advantages of scale achieved through its more than 4,000 stores and its national network of approximately 2,500 customer service representatives.
3. The company is positioned to potentially benefit from a cyclical rebound in residential construction and higher U.S. infrastructure investment: Demand for paint tends to track new home construction, home prices, and existing home sales and purchases (home owners paint prior to selling and after moving into new homes).
4. Sherwin's $11 billion Valspar acquisition (the fifth largest global coatings company in the world) should continue to enhance the combined company's long-term growth profile as the combination of the two companies is complementary. Notably, the addition of Valspar's product line will expand Sherwin-Williams' geographic penetration and its industrial coatings presence.

Shares of **Brookfield Asset Management, Inc**. gained 10.2% in the third quarter. Brookfield is a global alternative asset manager with $129 billion in fee-earning capital. In addition to its high-quality real estate portfolio, the company owns and operates an equally impressive and diversified global portfolio of renewable power, infrastructure, and other private equity assets. Its broad range of assets generate high levels of predictable and sustainable cash flow.

Additionally, Brookfield benefits from certain barriers to entry that we think could ultimately lead to significant asset appreciation over time. There are abundant opportunities for Brookfield to grow cash flow in its asset management business (raising more fee-earning capital) and its real estate businesses (increasing occupancy and rents). Given the company's excellent long-term investment returns and its strong and liquid balance sheet, we believe there is a major runway for growth across its various businesses for several years. Finally, officers and directors own 20% of the company's shares. Accordingly, management's interests are aligned with its shareholders. We remain optimistic about Brookfield's long-term prospects.

Table III.
Top detractors from performance for the quarter ended September 30, 2018

	Quarter End Market Cap (billions)	Percent Impact
Vulcan Materials Company	$14.7	–0.70%
Summit Materials, Inc.	2.1	–0.64
Installed Building Products, Inc.	1.2	–0.54
Eagle Materials Inc.	4.1	–0.35
Martin Marietta Materials, Inc.	11.5	–0.34

We are quite disappointed in the second quarter business results and third quarter share price performance of the Fund's construction materials companies–**Vulcan Materials Company**, **Summit Materials, Inc.**, **Eagle Materials Inc.**, and **Martin Marietta Materials, Inc.** Each company delivered varying degrees of inadequate earnings results and business outlooks, citing numerous headwinds including labor bottlenecks, shipping interruptions, unfavorable weather, cost pressures (such as higher diesel prices), and delays in pent-up demand in certain residential, commercial and infrastructure projects. After each company's second quarter results were announced, we sharpened our diligence. Our sense is that recent business obstacles may not be short lived. As such, we have reduced the Fund's position in each company.

We maintain, however, that the long-term prospects for each company are attractive because the key demand drivers for their businesses–government spending on infrastructure projects as well as residential and non-residential construction levels–remain at cyclically depressed levels and should increase over time. However, while these four companies present good prospects for strong intermediate and long-term growth, their near-term prospects appear to be less certain.

Installed Building Products, Inc. ("IBP") is one of the nation's largest insulation installers in the residential new construction market, and is also an installer of diversified complementary building products. The shares have been under pressure throughout 2018. Early in the year, increased costs negatively impacted cash flow margins, thus weighing on IBP's share price. Given that approximately two-thirds of IBP's business is generated from new single-family housing construction, a slowdown in the housing market, which seems to have emerged this summer and continued into the fall, has extended IBP's share price pressure. Accordingly, we have exited most of the Fund's position in IBP and may look to reacquire shares in the future.

Portfolio Structure

In prior letters, we have described the structure of the Fund's portfolio along what we believe are compelling cyclical, secular, and geographic investment opportunities. Examples are:

Cyclical investments: Leading hotel and timeshare companies, residential building products and services companies, and construction materials companies.

Secular investments: Wireless tower and data center companies.

Geographic investments: Las Vegas-centric real estate companies, international real estate companies, and certain "best-in-class" REITs.

In this letter, we are introducing an additional approach to categorize the Fund's portfolio holdings. We believe it may help to further illuminate how the Fund has been structured.

In 2018, the portfolio has been structured into four real estate buckets or categories:

1. **REITs**

   Over the course of 2018, we have allocated approximately 30% of the Fund's net assets to REITs. We believe an allocation to REITs in the Fund's diversified real estate-related portfolio is prudent. REITs, as dividend-yielding securities and bond proxies, offer an element of diversification versus the other real estate-related equity securities that populate 70% of the Fund's net assets.

   In addition to real estate diversification benefits, the Fund's REIT category provides other notable positives, which include generally steady and growing commercial real estate cash flows, new construction activity that is presently moderated by high construction and labor costs, reasonable and in some cases "cheap" valuations, solid balance sheets, and attractive dividend yields.

   On the other hand, the share price direction of REITs continues to be highly sensitive to fluctuations in interest rates. In the last few years, REITs and other dividend-yielding securities have tended to perform best in a declining interest rate environment as the relative appeal of a REIT dividend versus the U.S. 10-Year Treasury yield has improved.

   Conversely, REITs have generally lagged during periods when economic growth has increased and consequently interest rates have risen. For example, in 2018 the 75 basis point increase in the U.S. 10-year treasury yield from 2.40% to 3.15% has served as a key headwind to positive and relative share price performance for many REITs.

2. **Housing-Related Investments**

   For much of 2018, housing-related companies have approximated 25%-to-30% of the Fund's net assets. Included in this category are investments in homebuilders, building product and services companies, land developers, construction material companies, and home centers.

   For the last few years, we have been bullish regarding the prospects for the U.S. housing market. The residential annual construction rate of approximately 1.2 million new homes has remained 20% below the 60-year annual average of 1.5 million new homes even though the U.S. population is approximately 90% larger today (approximately 325 million) than it was 60 years ago (approximately 172 million)!

   We have maintained that the large imbalance between pent-up housing demand and low construction levels bodes well for new single-family home purchases and prices. Additional positive factors include low mortgage rates, improvement in job and wage growth, positive signs that the millennial generation has begun to buy homes, lower personal income taxes, and the recent uptick in the rate of home ownership.

   We anticipated that, in 2018, further strengthening of the U.S. economy and a more secure and optimistic consumer (given low unemployment, higher wages, and lower taxes), would continue to boost demand for the lingering cyclically depressed U.S. housing market. Surprisingly, however, activity in the housing market has slowed in the last few months – in some cases dramatically – due to a few key reasons:

First, national home sales have slowed due to home price affordability concerns. In the last 6 ½ years, national home prices have increased 46%, on average, versus cumulative wage gains of only 14%! Consequently, many would-be home buyers have now hit the "pause button" after several years of home price appreciation that has outstripped wage gains.

Second, in 2018, the increase in mortgage rates has served as an additional headwind to home price affordability for both first-time home buyers and those that are considering selling an existing home to move into a new home.

Third, recent tax reform has capped property tax and mortgage interest deductions, negatively impacting potential home buyers in several states that tend to have higher priced homes such as California, New York, New Jersey, and Connecticut.

Fourth, we believe that the emotional and financial scars from the 2008/09 housing crisis linger in the minds of several potential home buyers and may be causing some caution before purchasing a home.

Fifth, additional headwinds such as unfavorable weather, labor bottlenecks, and cost pressures have also affected home construction and purchases.

Importantly, we do not believe the 2018 slowdown in the housing market is the beginning of a major negative inflection point for the U.S. housing market. Instead, we suspect that the current housing market slowdown represents a pause in what will continue to be a multi-year housing recovery.

Unlike the 2008/09 housing crisis, today's housing market maintains a favorable imbalance between housing demand and supply. Home prices, while a bit stretched, remain more affordable than they were in 2008/09. Additionally, the prospects for the U.S. consumer appear to be improving as wage gains have begun to pick up.

Despite our longer-term bullish stance on the U.S. housing market, we have decreased the Fund's investments in housing-related securities (16.3% of the Fund's net assets as of 9/30/2018) due to the current lull in the housing market. We believe valuations are becoming compelling. We will continue to monitor the housing market closely, and may look to add additional housing-related investments should business prospects improve.

3. Pro-Growth, Less Interest Rate Sensitive Categories

The Fund has approximately 30% of its net assets allocated to real estate-related categories that often perform well in a strong economic environment. These include hotels (approximately 10% of Fund's net assets), casino and gaming companies (approximately 10%), vacation timeshare companies (approximately 5%), and cruise lines (approximately 5%).

Hotel Companies

Hotel company performance in 2018 has been mixed. On the positive side, corporate business and leisure travel demand has improved. This has occurred at a time when supply growth appears to be peaking, partly due to high construction and labor costs. Conversely, hotel occupancy and room rate growth appear to be trailing overall GDP growth, and we suspect that there are some concerns that hotel cash flows could decrease if economic growth slows.

Casino and Gaming Companies

The share price performance of several casino and gaming companies (such as **MGM Resorts International**) have lagged thus far in 2018 due in part to a recent slowdown in demand in Las Vegas (we view this slowdown as temporary), and concerns that a moderation in Chinese economic growth may negatively impact casinos with properties in Macau.

Moreover, regional casino and gaming companies (such as **Penn National Gaming, Inc.**, **Boyd Gaming Corporation**, and **Red Rock Resorts, Inc.**) with little or no exposure to Macau or the Las Vegas downtown strip, have nevertheless been incorrectly grouped with the other casino companies that do have international and Las Vegas strip exposure, and therefore have also seen their own share prices under pressure. We believe the share price weakness in several casino and gaming companies has presented several attractively valued investment opportunities.

Vacation Timeshare Companies

The share prices of vacation timeshare companies have also corrected in 2018 for reasons cited later in this letter. Our sense is that business fundamentals remain solid, and current valuations are compelling.

Cruise Line Companies

In the first nine months of 2018, the Fund's investments in cruise line companies, **Norwegian Cruise Line Holdings, Ltd.** and **Royal Caribbean Cruises Ltd.**, have performed well. Early indications suggest that business results in 2019 will remain strong given that consumers have been booking 2019 cruises at an earlier and faster rate than in previous periods. Cruise line stocks historically have traded in a range of 10-to-20 times earnings (average multiple of approximately 15 times earnings). Currently, Norwegian trades at only 8.7 times its 2019 estimated earnings and Royal Caribbean trades at only 10.6 times its 2019 estimated earnings. We expect both companies to generate an average earnings growth of approximately 15% per year between 2018 and 2020. In our judgment, the valuations of both companies are attractive.

4. Other Investments

The Fund has maintained approximately 8% of its net assets in a group of other real estate companies. We remain bullish on the prospects for these investments. Examples include:

- **CBRE Group, Inc. –** The world's number one commercial real estate services company which is currently valued at only 11.7 times our estimate of 2019 earnings versus its historical multiple of approximately 16-to-17 times earnings.
- **Brookfield Asset Management, Inc.** – A premier owner and operator of real estate-related and other infrastructure assets, valued at a 20% discount to our assessment of intrinsic value.
- **CoStar Group, Inc.** – A leading provider of information and marketing services to the commercial real estate industry.

Summary Thoughts Regarding Portfolio Structure

The broad-based weakness in the share prices of certain segments of real estate in 2018–both commercial and residential–has been a big disappointment and a negative surprise. In prior periods when economic growth improved and interest rates rose at least 80 basis points (such as the time periods started during the course of 2010, 2012, 2015, 2016, and 2017), we have pursued a strategy that has resulted in the Fund generating positive returns and outperforming the MSCI US REIT Index in every instance. The Fund also outperformed its primary benchmark in all but the latest period.*

This strategy has included increasing exposure to real estate companies with short lease durations (such as hotels and casino and gaming companies), economically sensitive real estate companies (such as residential-related building product and services companies and construction materials companies), and companies with strong pipelines of future development projects and solid balance sheets.

2018, however, is the only period in the last nine years when several segments of real estate that have historically performed well in a solid economic and a rising interest rate backdrop, have disappointed thus far. This development has been a significant negative surprise for us this year.

How are we positioning the portfolio in response to developments in 2018?

Generally, we are "staying the course." We continue to believe that a balanced, expansive, and diversified real estate portfolio is a sensible long-term strategy.

We continue to favor companies that we believe should benefit from the ongoing recovery in the economy. Our ongoing discussions with most commercial and residential real estate companies suggest that business conditions are likely to remain solid for most companies, notwithstanding temporary slowdowns for some segments of real estate. We believe the investment cases for many of these companies is more compelling today than they were earlier this year due to the sharp correction in share prices, particularly to casino and gaming companies and many residential real estate-related companies.

We have, however, been making a few strategic adjustments.

First, we have been taking advantage of the largely indiscriminate sell-off in several real estate companies to upgrade some of the Fund's holdings. There are several "best-in-class"** companies that we believe are now "on sale" and are currently valued at attractive prices. Examples include **CBRE Group, Inc.**, **Brookfield Asset Management, Inc.**, and **Hyatt Hotels Corp.**

Also, as part of our preparation to capitalize on the emerging opportunity to buy fine companies at highly discounted prices, as of the date of this letter we are maintaining the largest cash position (approximately 10%) since the launch of our Fund in 2010. We will deploy this cash as these special buying opportunities re-emerge.

Table IV.
Fund investments in real estate-related categories as of September 30, 2018

		Percent of Net Assets
REITs		29.7%
Hotel & Leisure		19.5
Hotels & Timeshare/Leisure	14.4%	
Cruise Lines	5.1	
Building Products/Services		13.8
Casinos & Gaming Operators		10.4
Data Center Operating Companies[1]		9.6
Real Estate Service Companies		4.5
Real Estate Operating Companies		3.2
Homebuilders & Land Developers		2.5
		93.2
Cash and Cash Equivalents		6.8
		100.0%

[1] Total would be 17.5% if included data center REITs Equinix, Inc. and Digital Realty Trust, Inc.

Table V.
Top 10 holdings as of September 30, 2018

	Quarter End Market Cap (billions)	Quarter End Investment Value (millions)	Percent of Net Assets
American Tower Corp.	$ 64.1	$50.6	5.9%
Equinix, Inc.	34.4	49.1	5.8
InterXion Holding N.V.	4.8	42.2	5.0
Home Depot, Inc.	237.0	37.3	4.4
MGM Resorts International	15.0	33.8	4.0
Penn National Gaming, Inc.	3.0	27.5	3.2
Brookfield Asset Management, Inc.	44.2	26.9	3.2
GDS Holdings Limited	4.4	24.0	2.8
Norwegian Cruise Line Holdings, Ltd.	12.7	23.2	2.7
Vulcan Materials Company	14.7	22.9	2.7

* For the period 10/8/2010 – 2/10/2011, the 10-Year U.S. Treasury Yield rose 134 basis points. Institutional Shares of the Fund returned 16.61% vs. 13.85% for the MSCI Real Estate Index and 9.04% for the MSCI US REIT Index.
For the period 7/24/2012 – 12/31/2013, the 10-Year U.S. Treasury Yield rose 165 basis points. Institutional Shares of the Fund returned 60.33% vs. 32.83% for the MSCI Real Estate Index and 3.47% for the MSCI US REIT Index, on a cumulative basis.
For the period 1/30/2015 – 6/10/2015, the 10-Year U.S. Treasury Yield rose 84 basis points. Institutional Shares of the Fund returned 3.76% vs. (1.36)% for the MSCI Real Estate Index and (10.62)% for the MSCI US REIT Index.
For the period 7/8/2016 – 3/13/2017, the 10-Year U.S. Treasury Yield rose 127 basis points. Institutional Shares of the Fund returned 5.92% vs. 1.42% for the MSCI Real Estate Index and (8.43)% for the MSCI US REIT Index.
For the period 9/7/2017 – 9/25/2018, the 10-Year U.S. Treasury Yield rose 104 basis points. Institutional Shares of the Fund returned 3.13% vs. 8.36% for the MSCI Real Estate Index and 0.47% for the MSCI US REIT Index.

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

- 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, 2018

	Quarter End Market Cap (billions)	Amount Purchased (millions)
Marriott Vacations Worldwide Corp.	$5.3	$22.1
CyrusOne Inc.	6.6	17.5
Americold Realty Trust	3.7	11.8
GDS Holdings Limited	4.4	10.9
Hilton Grand Vacations Inc.	3.2	7.6

The shares of vacation timeshare companies **Marriott Vacations Worldwide Corp.** and **Hilton Grand Vacations Inc.** have been under pressure in 2018. We suspect a combination of profit-taking following strong share price performance, concerns about the impact from hurricanes and Hawaiian volcanoes, and concerns that consumers may be less likely to purchase vacation timeshares if economic growth slows, have weighed on each company's shares.

Marriott Vacations Worldwide, a leading timeshare company with more than 100 resorts, recently completed its acquisition of timeshare operator ILG, Inc. We suspect that certain "event-driven" and "momentum" investors have exited their shares in Marriott Vacations Worldwide in the last few months, thereby pressuring the company's share price.

Hilton Grand Vacations has made the strategic decision to allocate more of its current free cash flow toward real estate development rather than share repurchases – a decision that should generate greater cash flow growth over the long term. We suspect that some Hilton Grand Vacations shareholders have sold shares in the company because they prefer a less capital-intensive approach to growth ("asset light") and a greater emphasis on capital returns to shareholders (i.e., share repurchases and dividends).

We are bullish about these two companies and their long-term prospects. Accordingly, we have taken advantage of recent share price softness to acquire shares in both companies. Our sense is that business fundamentals remain solid and both shares are attractively valued. We also believe that each company's customer loyalty program (the Marriott Rewards loyalty program with 110 million members and the Hilton Honors program with 78 million members) serves as a key competitive advantage to source future growth. Finally, insiders have been buying stock of timeshare companies at prices above the level where the shares are currently trading–a bullish indicator, in our opinion.

In the third quarter, we acquired shares in **CyrusOne Inc.**, a leading data center REIT that owns and operates 43 data centers. We remain bullish about the prospects for real estate data center companies, because, in our opinion, we are in the early stages of dynamic data center growth opportunities. This is due to a growing number of companies outsourcing their technological needs to high-tech and state-of-the-art data center firms. Data center outsourcing is expected to grow by 100% in the next five years, partly fueled by explosive growth in data and cloud computing. Cloud spending is projected to grow by 400% in the next five years.

CyrusOne, in our opinion, is well positioned to capture an attractive portion of this significant growth opportunity because its management team, led by CEO Gary Wojtaszek: (i) is in the process of building one of the few global data center companies so that CyrusOne will be better positioned to service its global customers; (ii) prioritizes its "sales-driven culture" which continues to result in the company gaining market share versus its competition; and, (iii) prioritizes a strong and liquid balance sheet with the goal of attaining investment grade status so that the company is better positioned to grow.

The shares of **Americold Realty Trust** increased 2.2% for the period held after reporting strong business results. The company is the only REIT that focuses on owning and operating temperature-controlled warehouses, and 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 also anticipate that Americold will bolster its growth by developing additional warehouses at attractive returns and through additional acquisitions of other temperature-controlled warehouses. We continue to believe the prospects for the company are strong, and the shares remain attractively valued relative to most REITs.

In the third quarter, the Fund acquired additional shares of **GDS Holdings Limited** at what we believe is an attractive price by taking advantage of its lower share price. The shares had been under pressure due to a negative "short seller" report. We have conducted extensive diligence on the company and believe the report's conclusions are overstated and inaccurate. More recently, the shares have likely been under pressure due to China "macro" concerns such as U.S.-China trade issues and a moderating Chinese economy. We believe both concerns will pass over time.

GDS is the leading developer and operator of data centers in China, with a customer base of more than 400 predominantly large technology and internet companies.

We have met with management on several occasions and are bullish on the company's long-term prospects for the following reasons:

- The Chinese digital economy is in an early growth phase, with relatively low national internet access penetration. It is predicted that China will experience the sharpest universal growth in public cloud spending in the next few years.
- GDS is the leading data center provider to the fastest growing companies in China including Baidu, Alibaba, and Tencent. Moreover, GDS has been designated as the preferred data center provider for Alibaba and Tencent.
- Its data centers are concentrated in the "Tier 1" major cities of China including Beijing, Shanghai, Shenzhen, Guangzhou, and Chengdu.
- GDS generates attractive 25% return on investment on its new data center developments.
- We believe the company will grow its cash flow by more than 100% in the next three years, and the shares are now attractively valued relative to its growth rate.

Table VII.
Top net sales for the quarter ended September 30, 2018

	Quarter End Market Cap or Market Cap When Sold (billions)	Amount Sold (millions)
Vulcan Materials Company	$ 14.7	$28.7
Mohawk Industries, Inc.	16.4	23.3
Eagle Materials Inc.	4.1	15.4
Martin Marietta Materials, Inc.	11.5	14.6
Home Depot, Inc.	237.0	13.4

We recently reduced the Fund's exposure to construction materials companies **Vulcan Materials Company**, **Eagle Materials Inc.**, and **Martin**

Marietta Materials, Inc., following disappointing second quarter earnings reports and subsequent research that suggests that a portion of the issues that have plagued each company may linger.

We maintain, however, that the long-term prospects for each company are attractive because the key demand drivers for their businesses – government spending on infrastructure projects, residential and non-residential construction levels – remain at cyclically depressed levels and should increase over time. We will continue to monitor business conditions and may increase our investments in the future should business prospects improve.

We exited the Fund's longtime holding in **Mohawk Industries, Inc.** following strong share price performance in 2017. We have some concerns that a large portion of the U.S. flooring industry (e.g., carpets, ceramic, hardwood) is losing market share to luxury vinyl tile, and therefore this segment is generating little to no growth and its profitability margins may have peaked.

We trimmed the Fund's large position in **Home Depot, Inc.** following several years of strong share price performance. We remain optimistic about Home Depot's long-term prospects, and therefore, continue to hold it in the Fund.

Outlook

In our second quarter shareholder letter, we referenced a Morgan Stanley report titled **"The End of Easy,"** which was published on May 13, 2018. In that report, the authors noted that the stock market performance in the last nine years has exceeded the performance of the economy due to multiple positive tailwinds that included low inflation, historically low interest rates, and positive U.S. policy catalysts (e.g., tax reform).

Looking forward, however, the authors predicted that *"the end of easy"* stock market performance may be approaching, as these previously positive factors (i.e., the goldilocks environment of moderate growth, low inflation, low interest rates, an accommodative Fed, and other factors) start to moderate, and advance more modestly. The essence of the report is that when this occurs, the economy will outperform the stock market.

We said that Morgan Stanley's thesis may prove to be prescient. In fact, recent economic data and Federal Reserve commentary portend that the "the end of easy" may be near. For example, the latest reports regarding job growth, consumer confidence, and consumer spending have all been quite strong. Additionally, inflation is approximately at the Fed's 2% objective. Moreover, Fed Chairman Jerome Powell has remarked that "very accommodative policy is no longer appropriate in the current environment." Interest rates have, once again, begun to rise.

We continue to be of the view, however, that no one has a crystal ball regarding how macroeconomic changes, political events, and central bank actions may unfold, and what the market's reaction will be to those events.

We acknowledge that there are a few "yellow flags" of caution in some segments of real estate and the stock market. Notably, interest rates have resumed their upward advance in the last few weeks in response to strong economic growth and somewhat "hawkish" commentary from Fed Chairman Powell who stated that "we may go past neutral (interest rates), but we're a long way from neutral at this point." Our antenna will remain up. We will continue to monitor those factors that influence real estate most directly such as construction activity, demand prospects, lending practices, interest rates and credit spreads, bank liquidity, and valuations. We also weigh macro dynamics that could impact certain segments of real estate such as economic growth, inflation, interest rates, oil prices, and the strength of the U.S. dollar.

While it is plausible that the outlook for real estate and the market may be tempered in the near term–perhaps as "the end of easy" growth materializes–we continue to identify several attractive investment opportunities for selected commercial and residential real estate stocks, given generally solid business prospects and compelling valuations.

Regarding real estate valuations, large segments of real estate-related stocks have declined sharply in 2018 in what feels like a "sell now, ask questions later" mentality. In our opinion, this broad-based and sharp price correction has left many real estate-related companies at valuations that are at the lowest levels in several years. We are identifying several companies that are just too "cheap" today and have good prospects for strong returns over the next few years.

A Final Word on the Baron Real Estate Fund

It is our sincere hope that you have found the content of this letter informative.

While the Fund's performance thus far in 2018 has been disappointing, and below our historical pattern of outperformance, we believe it is an anomaly. Our team is highly energized and motivated to "right the ship." I am optimistic that we will do so as we have done in the past, although we cannot guarantee that will be the case.

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

Baron Real Estate Fund

Investors should consider the investment objectives, risks, and charges and expenses of the investment carefully before investing. The prospectus and summary prospectus contains 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.