Dear Baron Small Cap Fund Shareholder:

Performance

Baron Small Cap Fund (the "Fund") had a great year. The Fund gained 9.46% (Institutional Shares) in the fourth quarter. Though strong, this was less than the Russell 2000 Growth Index (the "Index"), which was up 11.39%, and a little better than the S&P 500 Index, which was up 9.07%. For the year, the Fund really shined, gaining 34.87%, which well outpaced both the Index (up 28.48%) and the S&P 500 Index (up 31.49%). We are excited about both our absolute and relative performance for the year. The market had its best year since 2013 and traded to all-time highs, and the Fund exceeded market returns.

The Fund has now outperformed the Russell 2000 Growth Index for all the last 1-, 3-, 5-, 10-, and 15-year periods. Since inception, the Fund has beaten the Index by about 4% annualized.

Table I.
Performance
Annualized for periods ended December 31, 2019

	Baron Small Cap Fund Retail Shares[1,2]	Baron Small Cap Fund Institutional Shares[1,2,3]	Russell 2000 Growth Index[1]	S&P 500 Index[1]
Three Months[4]	9.37%	9.46%	11.39%	9.07%
One Year	34.50%	34.87%	28.48%	31.49%
Three Years	16.56%	16.87%	12.49%	15.27%
Five Years	10.53%	10.83%	9.34%	11.70%
Ten Years	12.73%	13.02%	13.01%	13.56%
Fifteen Years	8.96%	9.16%	8.81%	9.00%
Since Inception (September 30, 1997)	10.19%	10.33%	6.35%	7.68%

The market was strong in the fourth quarter, as the concerns that had been weighing on the market dissipated. The U.S. and China came to an agreement on a Phase 1 trade agreement, quieting a major fear. The Federal Reserve lowered rates by 25 basis points in October and indicated it will keep interest rates low, as inflation remains tame. Ten-Year government bonds are trading around 1.8%, down significantly from 2.8% earlier in the year.

The economic picture remained relatively unchanged, with strong labor reports (unemployment is near a 50-year low), solid consumer spending, offset by weakness in the industrial/manufacturing sectors, with much of the softness being caused by uncertainty resulting from trade conflict. The global growth outlook has improved from the lag effect of lower interest rates, fiscal stimulus that is lifting the Chinese economy, and Europe is more stable with Brexit moving forward.

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Retail Shares: BSCFX
Institutional Shares: BSFIX
R6 Shares: BSCUX

Growth stocks resumed leadership in the quarter. Remember, there was a big shift to value at the end of the third quarter. That proved to be short lived. Small stocks outperformed bigger ones. Volatility and higher beta stocks were in vogue. The leading sector in the small-cap space this quarter was Health Care stocks (not Information Technology ("IT") as earlier in the year), especially biotechnology and pharmaceutical stocks, which were up 33.5% and 30.7%, respectively. Since the Fund is virtually uninvested in these sub-industries, we underperformed the Index this quarter. Other than our underweight in Health Care, our stocks performed very well.

For the year, our outperformance was aided by our concentration on investments in high-quality growth companies, with greater earnings stability and low volatility. Our tilt toward relatively larger market caps helped. Also, we have been overweight in IT, which was the best sector in 2019. Our second largest exposure was to Industrials, and even as this sector of the economy has been under pressure, our Industrials stocks performed marvelously…gaining 48.2% for the year. Our Health Care stocks gained 38.9% for the year, and our Consumer Discretionary stocks, our fourth largest segment, gained 34.4% for the year.

Performance listed in the above table is net of annual operating expenses. Annual expense ratio for the Retail Shares and Institutional Shares as of September 30, 2019 was 1.31% and 1.05%, 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 index performance is not Fund performance; one cannot invest directly into an index. The Russell 2000® Growth Index measures the performance of small-sized U.S. companies that are classified as growth and the S&P 500 Index of 500 widely held large cap U.S. companies. The indexes and the Fund are with dividends, which positively impact the performance results. Russell Investment Group is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell is a trademark of Russell Investment Group.

[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] Performance for the Institutional Shares prior to May 29, 2009 is based on the performance of the Retail Shares, which have a distribution fee. The Institutional Shares do not have a distribution fee. If the annual returns for the Institutional Shares prior to May 29, 2009 did not reflect this fee, the returns would be higher.

[4] Not annualized.

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The Fund excelled in 2019 because we had lots of great stocks. We had 18 stocks that were up 50% or more…which is pretty cool. They were an eclectic mix. Many of them were some of our largest holdings. Many were some of our longest held stocks, as well. These stocks, listed in order of greatest contribution to the Fund, were **The Trade Desk**, **TransDigm Group, Inc.**, **Installed Building Products, Inc.**, **Site One Landscape Supply, Inc.**, **Floor & Decor Holdings, Inc.**, **Teladoc Health, Inc.**, **John Bean Technologies Corporation**, **DexCom, Inc.**, **Ceridian HCM Holding Inc.**, **Summit Materials, Inc.**, **Clarivate Analytics Plc**, **Liberty Broadband Corporation**, **Guardant Health, Inc.**, **Repay Holdings Corporation**, **OneSpa World Holdings Limited**, **Endava plc**, **Avalara, Inc.**, and **Beyond Meat, Inc.**

Table II.
Top contributors to performance for the quarter ended December 31, 2019

	Percent Impact
The Trade Desk	0.87%
SiteOne Landscape Supply, Inc.	0.68
DexCom, Inc.	0.55
Teladoc Health, Inc.	0.49
Installed Building Products, Inc.	0.49

The Trade Desk, the leading internet advertising demand-side platform, was a top contributor this quarter, rebounding after declines in the third quarter. Revenue growth remains impressive, over 38% in the third quarter, as brands use Trade Desk's data-driven strategies to drive better ad campaigns. Video and connected TV are at a tipping point, driving advertisers to apply data to TV ad campaigns for the first time, and Trade Desk expects revenues from this medium to be up over 100% in 2020. We estimate Trade Desk growth to remain at 30%+ into 2020, as the programmatic market, and the company's share (only 10%) of that market, continues to grow.

SiteOne Landscape Supply, Inc., the largest distributor of wholesale supplies to the landscape trade in the U.S., posted strong third quarter results including 7% organic growth as weather normalized, 13% sales growth, and 18% EBITDA growth. Its acquisition pipeline remains robust with larger-sized transactions that should carry into 2020. Initiatives to improve productivity and margins, such as bar-coding and freight management, are starting to bear fruit, and management's 10% EBITDA margin target seems in reach, even conservative in our mind.

A blow-out quarter for **DexCom, Inc.**, which sells continuous glucose monitoring ("CGM") devices for people with diabetes, led to a 47% stock increase in the fourth quarter. Sales were up 49% led by new patient growth, with U.S. sales up 53%, the largest increase since the first quarter of 2016. Management raised revenue guidance for the full year to 38% to 41% growth, which compares to original guidance at the start of the year of 14% to 19% growth. DexCom has been growing robustly since introducing its G6 product in early 2018, which eliminated the need for finger sticks, is easier to apply, and provides exceptional calibration. The company will introduce its next gen G7 platform in 2020, which promises to be the thinnest CGM ever and will have applications to broader classes of people with insulin issues in the non-intensive diabetes and pre-diabetes markets.

Teladoc Health, Inc., the global leader in virtual care, grew organic revenues 24% in the third quarter, with total visits growing 63% affirming the expanding role of virtual care globally. Teladoc now serves 54 million members, having added 15 million members through a new agreement with UnitedHealthcare. Utilization of existing services continues to increase, and the company is expanding the market by establishing additional use cases for virtual care. We believe that Teladoc is just scratching the surface of its long-term potential and believe the company can maintain strong organic growth supplemented by strategic acquisitions, as it continues to be the global leader in virtual medical care.

Installed Building Products, Inc. ("IBP") is a leading distributor and installer of insulation and complementary products in the U.S., serving both residential and commercial end markets. The stock rallied on 9% same-branch sales growth, illustrating the company's multi-dimensional growth drivers in a stable housing environment. Pricing growth was strong at 5%, residential non-insulation products grew 14%, and commercial was up 19%. Total sales grew 14% and margins expanded (after unprecedented inflation last year), leading to 28% EBITDA growth and 42% EPS growth. We expect momentum to continue in 2020, with same-branch sales growth of about 10%, total sales over 15%, and EBITDA over 20%. IBP's strong capital position ($235 million cash on its balance sheet) enables management to aggressively pursue acquisitions, which are accretive given its scale advantages in purchasing raw materials and expand and diversify the company's end-products and end-markets.

Other stocks that gained over 25% in the quarter but added less to the absolute performance of the Fund this quarter were: **HealthEquity, Inc.**, **Ceridian HCM Holding Inc.**, **Cision Ltd.**, **Planet Fitness, Inc.**, **Hudson Ltd.**, and **Abcam plc**.

Table III.
Top detractors from performance for the quarter ended December 31, 2019

	Percent Impact
Mercury Systems, Inc.	–0.33%
Americold Realty Trust	–0.11
IDEXX Laboratories, Inc.	–0.11
Cantel Medical Corp.	–0.07
Revolve Group	–0.07

Mercury Systems, Inc., the world's leading Tier-2 defense electronics producer and integrator, ended 2019 with a return over 46%, but fell from the highs it reached in the third quarter. Nothing fundamental changed with the company in the fourth quarter, and we came out of the Investor Day in early December with confidence in the company's long-term prospects. Mercury's innovation and business model enable Prime and government customers to outsource a trusted, secure, affordable subsystem. We believe Mercury can continue to grow organically around 10% and supplement that growth with strategic acquisitions to generate 20% revenue growth, leading to faster bottom-line growth with improving margins. Mercury continues to be a core investment in the Fund.

Shares of **Americold Realty Trust**, a REIT that owns and operates temperature-controlled warehouses, primarily in the U.S., declined after the company's third quarter results were negatively impacted by higher health insurance costs related to an increase in high dollar claims and start-up costs related to its Chicago development project. Chicago, as well as other new developments, may be slower to ramp (stabilized returns pushed out six months), but we are confident in the ultimate 12% to 15% returns on capital. Americold is the industry leader in cold storage who will benefit from positive tailwinds aided by consumer preferences toward fresh food and tight supply (high barriers to entry). We believe net operating income will continue to compound, and the multiple can expand, leading to good stock returns.

Shares of veterinary diagnostics leader **IDEXX Laboratories, Inc.** fell 4% in the quarter. Investors rotated out of high-multiple veterinary health care stocks and were marginally concerned by a potential new lab competitor. Competitive trends favor IDEXX as is demonstrated by growing its instrument installed base by 18%, doubling its domestic lab growth, and improving sales productivity. New proprietary innovations and sales force expansion should be meaningful contributors to growth. Margins are moving significantly higher, and we believe that EBITDA margins can approach 30% over the next several years. The company announced that CEO John Ayers would step down from his position after a serious biking injury. We greatly admire John, wish him well, and thank him for leading the company and stock to great heights.

Shares of **Cantel Medical Corp.** dropped as revenue growth slowed. Its fastest growing medical segment slowed considerably (up only 5.7%) due, in part, to increased competitive activity. Cantel is taking strategic actions to re-accelerate growth in this segment, but it may take some time. New management continues to pursue large strategic acquisitions to refocus its portfolio. We sold some stock during the quarter but still believe in the strategy long term.

Apparel e-commerce retailer **Revolve Group**, a small position in the Fund, declined 21% in the fourth quarter despite posting sales growth of 22.5%. Gross margins were pressured by higher promotions of third-party products, as investments in owned brands drove inventory higher. Owned brands are 33% of sales and carry significantly higher margins, so investments to drive that percentage higher should pay off in time, but it may take a few quarters. Revolve lowered the high end of full-year revenue and EBITDA guidance by $1 million, which is not a big deal to us. Revolve's proprietary, data-driven technology platform powers a read and react merchandising model that offers Millennials/Gen-Z customers a curated, differentiated assortment (60% of brands not found elsewhere) with free shipping/returns. As Revolve gains more share of its customers on-line spend, we see top-line growth of over 20% with EBITDA and EPS growth of 30% in the coming years.

The other holding that fell over 20% in the quarter was PagerDuty.

Portfolio Structure

As of December 31, 2019, the Fund had $4.1 billion under management. The top 10 holdings made up 30.4 % of the Fund's assets. We owned 72 stocks.

Table IV.
Top 10 holdings as of December 31, 2019

	Year Acquired	Quarter End Investment Value (millions)	Percent of Net Assets
Guidewire Software, Inc.	2012	$164.7	4.0%
Gartner, Inc.	2007	154.1	3.8
ASGN Incorporated	2012	124.2	3.0
Bright Horizons Family Solutions, Inc.	2013	124.0	3.0
ICON plc	2013	120.6	3.0
SBA Communications Corp.	2004	120.5	3.0
SiteOne Landscape Supply, Inc.	2016	117.8	2.9
Waste Connections, Inc.	2016	108.9	2.7
Installed Building Products, Inc.	2017	103.3	2.5
Floor & Decor Holdings, Inc.	2017	101.6	2.5

As in the recent past, the Fund's largest concentrations were in IT (24.0% of net assets), Industrials (20.7%), Health Care (19.4%), and Consumer Discretionary (16.3%). Compared to the Index, we were overweight in IT, Consumer Discretionary, and Industrials; and underweight Health Care…also consistent with our relative weightings for the last few years. We were light in our ownership of Financials and didn't own any Consumer Staples, Utilities, and Energy. We were overweight in Real Estate, Communication Services, and Materials. These weightings came from our bottom-up work, and though we hold our stocks for the long term, we do trade around our positions to take advantage of near-term opportunities or reduce our winners into strength.

During the year, we tweaked our weightings. We entered the year about 8% higher in our IT holdings, as we thought that sector and our holdings were particularly attractive after getting shellacked in the fourth quarter of 2018. As we explained then, we felt it was right to "keep our foot on the gas." These stocks were particularly strong in the first half of the year. We then reduced our IT exposure into strength as valuations increased, and we found opportunities elsewhere. We increased our holdings in each of the Industrials, Consumer Discretionary, and Health Care segments and our timing was beneficial, as those sectors performed better later in the year. As trade tensions calm down and political concerns sort out, we are finding opportunities in more economically sensitive sectors.

We are long-term investors in small-growth companies. At year end, about 19.5% of the Fund's assets were invested in stocks we have owned for over 10 years and another 27.5% was invested in stocks we have held between 5 and 10 years. This is highly unusual for small-cap funds, but it is our calling card. We own these stocks for such long periods because we have earned high returns on our long-term holdings…25.7% annualized on the first group, and 25.1% on the second group. To us, these returns validate our long-term approach. The focus of our hunt for new stocks is to seek out a new crop of long-term winners to replicate these successes.

About 33% of our Fund's net assets are invested in securities that have increased five-fold or more since their initial purchase, and another 30% of the Fund's net assets are invested in securities that have more than doubled since their initial purchase. We have come to learn, through our years of managing money, that companies can succeed for longer periods of time than one might think, and that the best companies can continue to evolve for the better with unforeseen opportunities developing as they mature. Their stocks can continue to perform longer than one might expect. In 2019, many of our best performing stocks were stocks that we had held for a long time and already had appreciated multiple fold….such as, **TransDigm Group, Inc.** (up 85% for the year), **SBA Communications Corp.** (up 49%), **IDEXX Laboratories, Inc.** (up 40%) and **Ultimate Software Group, Inc.** (up 35%) to name a few. This is what it really means to be a *true* long-term investor. Finding these companies and having the courage and wisdom to maintain conviction is our secret sauce. Our approach is to hold onto the stocks of these great companies, but to trim the number of shares we own, so that they are properly sized in the portfolio and so that we can be true to our market-cap mandate. We now hold only a small fraction of the shares we held at peak in many of our long-term holdings and big winners. We own about 20% or less of our peak position in TransDigm, SBA, **Mettler-Toledo International, Inc.**, IDEXX, **Gaming and Leisure Properties, Inc.**, **Berry Global Group, Inc.**, and **Cognex Corporation**.

We use the capital we raise from trimming these positions and other stock sales to reinvest in new small-cap names. During the year, we bought 18 new stocks, which as a group had a weighted average market cap at purchase of $1.5 billion. Including our additions to previously owned stocks, the weighted average market cap of our new investments was $1.8 billion. These purchases contrast starkly with the average market cap of stocks sold. We trimmed stocks with a weighted average market cap of $12.6 billion. The combined weighted average market cap of our trimmed and sold positions was $10.2 billion. So, even as our Fund had strong appreciation, and many of our larger-cap stocks performed well, the "size score" of the Fund was basically flat for the year.

Recent Activity

Table V.
Top net purchases for the quarter ended December 31, 2019

	Year Acquired	Quarter End Market Cap (billions)	Amount Purchased (millions)
GS Acquisition Holdings Corp	2019	$1.0	$21.9
ChaSerg Technology Acquisition Corp.	2019	0.3	20.6
Kinsale Capital Group, Inc.	2019	2.3	17.7
Quaker Chemical Corporation	2019	2.9	15.1
PolyOne Corporation	2019	2.8	14.4

We continue to find great opportunity investing in Special Purpose Acquisition Companies ("SPACs"), having bought five such investments in 2019, which made up about 40% of our new purchases for the year. We purchased two SPACs this quarter: GS Acquisition Holdings and ChaSerg Technology Acquisition.

GS Acquisition Holdings Corp is led by David Cote, who has built a tremendous track record (+800% shareholder return) as CEO of Honeywell from 2002 to 2017. Cote will be Executive Chairman of the acquisition company Vertiv, a full-service provider of digital critical infrastructure solutions, with most applications and services sold into data centers, a growing industry. Vertiv is a pure-play provider with its sole focus on this channel, growing organically by mid-single-digits, with the ability to layer on acquisitions and meaningfully improve margins under new management, now independent from former parent Emerson Electric.

ChaSerg Technology Acquisition Corp.'s CEO, Lloyd Carney has a similarly impressive track record, most recently as CEO of Brocade after 25 years of experience leading technology companies. ChaSerg is acquiring Grid Dynamics, an emerging leader in driving enterprise-level digital transformation. The company boasts customers such as Kohl's, Raymond James, and Apple who are using Grid to help build in-house applications for the evolving digital world. Grid's quality of engineers is exceptional, leading to high client retention with average spending around $4 million per customer. Total sales have grown at a 30% CAGR since 2015, and EBITDA at a 25% clip. As a Firm, we have strong institutional knowledge of this industry, having made a bevy of successful investments. We are buying Grid at an attractive valuation–at a meaningful discount to its peers despite superior revenue growth and higher margins.

We initiated a position in **Kinsale Capital Group, Inc.**, a specialty insurance company focused on the Excess and Surplus ("E&S") lines market, after a rare earnings miss caused the stock to fall sharply. Third quarter premium growth was incredibly strong at 41%, but reserve development was less favorable than expected. These factors, combined with broader industry concerns about rising loss severity, sent the stock lower. Kinsale has been a terrific stock since its IPO and is held in other Baron Funds, so we have been tracking it closely. Kinsale combines disciplined underwriting and claim handling with technology-enabled low costs to deliver attractive returns and growth. The company's focus is on smaller and sometimes hard to place accounts and, unlike competitors, maintains absolute control over the underwriting and the claim management process. Nothing is outsourced to external parties. All of this helps drive Kinsale's attractive loss ratios. In addition, Kinsale uses proprietary technology and automation to operate at a significant expense advantage over many larger competitors. Industry pricing is rising, and we expect this favorable pricing cycle will last for multiple years due to retrenchment by large competitors following years of underpriced business. With less than 1% market share of the E&S market and a sustainable underwriting and cost advantage, Kinsale should have a long runway of profitable growth.

We invested in two specialty chemical companies, **Quaker Chemical Corporation** and **PolyOne Corporation**, which have been on our radar for many years. In each case, an announcement of a transformational and highly accretive acquisition was the impetus of our investments.

Quaker blends base oils, synthetics, and additives to make lubricants, fluids, and greases used in primary metals, metalworking, and other specialty end markets. Quaker completed a merger with Houghton (#3 and #4 in the market) with a combined 250-year history to become the largest player in a $12 billion space. Internally, Quaker management dubbed the transaction "Made in Heaven" due to its strong talent and cultural fit, cross-selling opportunities given minimal customer overlap, $60 million plus of cost synergies, and headquarters a mere 25-minute drive apart! The transaction was held up for over two years for regulatory approval, so we expect a seamless integration and early wins on sales and cost synergies. For the past 10 years, sales have grown at an 8% CAGR, and EBITDA at 12%, giving credit to Quaker's differentiated customer-intimate business model enabling share gains 2% to 4% above market, which is stable, but low growth. Its "asset-light" model generates strong free cash flow that was used for accretive bolt-on acquisitions in the past, a trend we expect will continue. Quaker Houghton's mid-teens market share, enhanced capabilities, and global reach allows plenty of room for growth. We are most excited about the cross-selling opportunities that will enable Quaker Houghton to continue to grow mid-single digits organically, despite being twice the size.

PolyOne, a leading global provider of specialized polymer materials, services, and solutions announced its agreement to purchase Clariant's global color and additive masterbatch business for $1.45 billion in December. PolyOne's innovation, technology, and service are differentiators in helping customers add distinguishable colors (e.g., Tide Orange) to their products, while improving recyclability. Commercial investments fuel organic growth, and a strong cash generative business has enabled accretive M&A, the result of which has been 10 consecutive years of EPS growth and annual dividend increases from $0.16 in 2011 to $0.81 currently. In conjunction with the acquisition announcement, PolyOne raised fourth quarter 2019 EPS guidance implying 9% growth for 2019, a solid mark in a difficult industrial backdrop. The Clariant acquisition marks another step of a multi-year evolution toward a higher valued portfolio, one we think will warrant a

higher multiple in time. The acquisition has been on the company's wish list since we have covered the stock. PolyOne expects to recognize $60 million of cost synergies, and cross-selling opportunities could add 1% to 3% of potential incremental sales in time. Clariant's business has a more consumer-oriented end market exposure (health care, packaging) that should result in more stable performance. Using equity to fund this deal, PolyOne will retain balance sheet flexibility to continue pursuing future bolt-ons, most likely targeting the growing composites market. This business alone could be multiples of its $200 million revenue base today. PolyOne is paying an upfront multiple of 11.1 times EBITDA, but we think the combination will create tremendous value, with the ultimate price paid well below 7.5 times.

Table VI.
Top net sales for the quarter ended December 31, 2019

	Year Acquired	Market Cap When Acquired (billions)	Quarter End Market Cap or Market Cap When Sold (billions)	Amount Sold (millions)
Cision Ltd.	2017	$1.2	$ 1.5	$59.5
The Trade Desk	2017	1.7	11.7	32.8
Nordson Corp.	2009	1.9	9.6	24.7
SiteOne Landscape Supply, Inc.	2016	1.1	3.8	18.1
TransDigm Group, Inc.	2006	1.1	30.0	17.4

Cision Ltd. shares rose sharply after the company announced a definitive agreement to be acquired by private equity firm Platinum Equity at a reasonable premium. Concern that surplus NYC office supply would continue to pressure rents and cash flow growth led us to fully exit SL Green Realty Corp., a stock we held for 10 years and generated about a 400% total return (16.8% annualized). We are proud to have owned **Nordson Corp.** for 10 years, generating a 580% cumulative return (21.2% annualized). It is a paragon of companies we look for in the Industrials sector–a dominant player in its niche led by an innovative culture, a track record of above-market organic growth, a steady after-market business, high margins, and free cash flow to enable acquisitions, dividends, and share repurchases. Nordson gives back 5% of its annual profits to local charities, another aspect we admire. It is such a fine company in all aspects. With the company's growth rate slowing, the stock at an all-time peak multiple, management changes at the top, and better investment prospects in other Industrials stocks (mentioned above), we decided it was time to exit. SL Green and Nordson were great businesses that were trading at excessive discounts in 2009, during the financial crisis, and identifying and holding those have generated great returns for shareholders. We also sold our small position in Pagerduty, Inc. as it is unclear who will emerge in a competitive monitoring and IT service market.

The Trade Desk was our best stock in 2018 as well as in 2019 (+124%). It generated a cumulative return of over 500% in under three years, and, while still a meaningful position, we trimmed into strength. Similarly, with **SiteOne Landscape Supply, Inc.**, Guidewire Software, Inc., and **TransDigm Group, Inc.**, we trimmed position sizes in these larger-cap names into strong fourth quarter performance.

Outlook

The environment entering 2020 continues to be favorable. Growth is solid, and we expect it to improve, as the negative effects of the trade war lessen and monetary stimulus kicks in. Interest rates are very low, which is good for business and the market (higher multiples). Inflation is subdued. Consumer confidence is high and spending robust. Corporate earnings are strong.

Tensions have flared up in the Middle East, between the U.S. and Iran. But as of now, cooler heads have prevailed, and the situation is not escalating. Oil matters less to geopolitics these days, since the U.S. is energy self-sufficient and the electrification of cars and the rise of alternative energy have reduced reliance on foreign sources. Hopefully, the situation will remain calm, but, if not, it won't be as disruptive as in the past.

2020 is an election year. There are some major differences in policies being espoused by the parties and the candidates within those parties. Some of the rhetoric is anti-business, and, if implemented, could change the economic picture and be an unfavorable environment for stocks, so this must be monitored.

The biggest concern we hear is that stocks are overvalued after the great gains last year. My perspective is a little different. Remember, companies (at least our holdings) had solid results in 2018, yet their stocks got hammered in the fourth quarter and were down for the year over concerns that the economy was going to go into a recession, that interest rates were going to rise, and that the trade war would seriously damage the global economy. The doomsday scenario never materialized. The declines at the end of 2018 were not justified…often the market gets things wrong…and stocks were undervalued at year end 2018 (as we highlighted in last year's year end letter). As businesses continued to perform in 2019, their stocks both caught up from the oversold conditions and grew along with earnings growth. Meaning, the performance of stocks, and our Fund, last year was not so extraordinary in context. We think our stocks, for the most part, are now properly valued, especially considering the positive investing environment, the quality of the businesses in which we have invested, and the near- and long-term prospects of our holdings. We believe that our companies, for the most part, can grow their value about 20% a year, and that multiples can hold, so we still have nice upside.

I would like to commend my Assistant Portfolio Manager, David Goldsmith, for his continued significant contribution to the management of the Fund. I would also like to call out and thank our stellar analyst group and portfolio managers at Baron for their fine work in identifying, researching, and covering our investments. I feel privileged to work with such a great group of smart, nice, and hard-working investors. Together, we will continue our pursuit of investing in special businesses that have significant growth opportunities, big barriers to competition, and are managed by executives who have demonstrated proven success, great vision, and high character. As these businesses perform, so will their stocks and our Fund.

Thanks very much for investing in Baron Small Cap Fund. I appreciate your confidence in us and am happy that we are doing well for our shareholders.

Cliff Greenberg
Portfolio Manager

Baron Small Cap Fund

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: The Adviser believes that there is more potential for capital appreciation in smaller companies, but there also may be more risk. Specific risks associated with investing in smaller companies include that the securities may be thinly traded and they may be more difficult to sell during market downturns. The Fund may not achieve its objectives. Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

Beta measures a fund's sensitivity to market movements. The beta of the market is 1.00 by definition.

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