Baron Real Estate Fund 3Q22 Performance Review and Portfolio Positioning

Performance Review

Baron Real Estate Fund declined 4.86% in the third quarter of 2022, slightly outperforming its primary benchmark, the MSCI USA IMI Extended Real Estate Index, which declined 4.99%. The Fund significantly outperformed the MSCI US REIT Index, which declined 10.28%.

There is no question that 2022 has been a challenging year for equities, and real estate equities were no exception. We have been taking advantage of the sharp corrections in the share prices of many businesses to invest in and add to quality real estate companies, many of which are now trading at attractive valuations.

We remain mindful of the reasons to be cautious and understand that stocks may go lower in the months ahead. Nevertheless, we believe the shares of several real estate-related companies and our real estate portfolio may benefit from asymmetrical returns in the next two to three years with significantly higher upside.

- Top contributors included **CoStar Group, Inc., Las Vegas Sands Corporation,** and **Vulcan Materials Company.**
    - Shares of real estate data and marketing platform **CoStar Group, Inc.** contributed to performance on strong financial results and its addition to the S&P 500 Index. We believe the company is well positioned to benefit from the continuing migration of real estate market spend to online channels. CoStar is investing aggressively to build out its residential marketing platform, which will launch later in 2022 and offers significant upside potential, in our view. CoStar has over $4.7 billion of cash on its balance sheet, which we expect it to begin to deploy for opportunistic M&A.
    - **Las Vegas Sands Corporation,** an owner and operator of casinos in Macau and Singapore, contributed in the quarter after Macau announced it was loosening many COVID-related restrictions, including the reintroduction of group tours and visas that contributed 50% of pre-pandemic visitation, to restart in late October/early November. Acceleration of the recovery in Singapore from its pre-COVID lows also boosted the share price. Sands has a stellar balance sheet and continues to invest in projects in Macau and Singapore.
    - **Vulcan Materials Company** is a leading provider of aggregates, cement, and asphalt materials used for residential and non-residential construction projects in the U.S. Shares increased on investor enthusiasm that federal stimulus targeting infrastructure spending will accelerate demand for Vulcan's products. We remain shareholders. In our view, Vulcan is a high-quality company in an industry with high barriers to entry. We believe the valuation is reasonable relative to the quality of the company and growth potential.

- Top detractors included **Prologis, Inc., American Tower Corp.,** and **Brookfield Asset Management Inc.**

  - **Prologis, Inc.** is the leading global owner, operator, and developer of industrial warehouse real estate. Shares declined on investor concerns that a potential recession could negatively impact business fundamentals that are exceptionally strong at present. We remain shareholders. In our view, industrial real estate has attractive long-term fundamentals, with organic growth that is among the highest across all real estate asset types. Given Prologis's assets, markets, management, and balance sheet, we believe it is well positioned to benefit from this favorable backdrop.

  - **American Tower Corp.** was a detractor from performance during the quarter due to the impact of rising interest rates on REIT valuations overall alongside currency headwinds as a result of the strong dollar. American Tower owns and operates 220,000 cell phone towers with 40,000 in the U.S. and 180,000 internationally. We retain conviction based on durable demand drivers in data growth and video combined with the company's proven ability to grow its portfolio and return excess capital to shareholders.

  - **Brookfield Asset Management Inc.** was a detractor from performance due to the negative impact of a more expensive financing environment on its ability to realize investment gains and deploy capital at attractive internal rates of return. Brookfield invests in real estate, infrastructure, renewable power, private equity, and credit globally and has over $750 billion AUM and $400 billion of fee-bearing capital. We retain conviction given the company's diversified asset base, sustainable cash flows, strong asset management platform, and ability to deploy capital globally.

Portfolio Positioning

We have been actively managing the Fund with the goal of maximizing opportunities and minimizing risk given the highly unusual macro-economic and geopolitical environment, as follows:

- <u>Higher cash percentage</u>: We have maintained an elevated cash position, currently standing at 13.2% of net assets. We expect to begin to deploy this cash given the sharp correction in the share prices of certain real estate companies and as other special buying opportunities emerge.

- <u>Fewer holdings</u>: We have decreased the number of positions by about a third to 40 holdings, prioritizing our highest conviction best-in-class companies and trimming or exiting smaller, more leveraged, and/or less liquid companies or those exposed to regions that may face headwinds.

- <u>Short-lease duration real estate with pricing power</u>: We are emphasizing companies that can raise rents and prices on a regular basis to combat inflation. Examples include hotel, casino, self-storage, apartment, single-family home rental, and manufactured housing real estate companies.

- <u>Secular growth real estate companies</u>: Companies that benefit from secular tailwinds where cash flow growth tends to be durable and less sensitive to a slowdown are a long-term focus. Examples include wireless tower, data center, industrial logistic, and life science real estate companies.

- Cyclical real estate companies: Despite expectations for a further slowdown and recession, we own several economically sensitive and cyclical companies whose share prices are attractively valued. Examples include certain homebuilding and travel-related real estate companies.

We continue to prioritize four investment themes or real estate categories:

- **REITs**
  We have tended to limit our REIT allocation to 25% to 35% so that the Fund is differentiated from most REIT funds. Business fundamentals for several REITs are solid although we expect slower growth in 2023. Should the slowdown evolve into a mild recession and rates peak and then start to decline, certain REITs may perform relatively well given the contracted nature of cash flows and attractive dividend yields. Our REIT companies and categories include technology-centric wireless tower and data center REITs, residential-related REITs, and industrial REITs.

- **Residential-related real estate companies**

  In the first quarter, we sharply lowered our exposure to residential-related real estate companies given significant share appreciation. We expect the near doubling of the mortgage rate, the more than 30% increase in home prices, and the deterioration in consumer sentiment in recent months will lead to a significant slowdown in the housing market.

  That said, we remain long-term bullish on the U.S. housing market. The fundamental drivers of demand remain in place, including favorable demographics, the significant supply/demand imbalance, and migration trends. We also believe the structural underinvestment in residential real estate construction relative to demographic needs should reverse. These factors bode well for new single-family home purchases and home and apartment rentals.

  We also believe the valuations of housing-related companies reflect a good portion of the forthcoming slowdown in the U.S. housing market and have begun to offer compelling multi-year return prospects. We have begun to reverse course and increase exposure to homebuilders, building product and services companies, and home centers.

- **Other real estate-related companies**

  This category includes companies that do not fit neatly in more traditional real estate categories, including commercial real estate services companies, real estate-focused alternative asset managers, and property technology companies.

- **Travel-related real estate**

  Though travel-related fundamentals have been strong, we have lowered our exposure because of unexpected headwinds, including the Ukraine war, high inflation, and the possibility of a sharp economic slowdown which may slow leisure and business travel.

  We are maintaining an allocation to certain companies for the following reasons:

  - We believe the valuations of several travel-related real estate companies are highly discounted relative to intrinsic value and offer excellent return prospects in the next two to three years.

- Certain travel-related businesses remain cyclically depressed, not secularly challenged, and should rebound as economic strength re-emerges.
- Our travel-related real estate holdings maintain well-capitalized and liquid balance sheets and should be able to comfortably withstand any slowdown in economic growth.
- We remain bullish about the long-term spending priorities of the consumer. Millennials, for example, continues to prioritize "experiences" such as travel over "goods."
- Private equity companies continue to highlight the travel segment as an investment priority. We would not be surprised if private equity firms take advantage of the favorable valuation arbitrage between the public and private markets and acquire public travel companies.

Baron Real Estate Fund's annualized returns for the Institutional Shares as of September 30, 2022: 1-year, (26.68)%; 5-year, 8.36%; 10-year, 10.34%. Annual expense ratio for the Institutional Shares as of December 31, 2021 was 1.05%.

The **MSCI USA IMI Extended Real Estate Index's** annualized returns as of September 30, 2022: 1-year, (20.39)%; 5-year, 4.17%; 10-year, 8.15%.

The **MSCI US REIT Index's** annualized returns as of September 30, 2022: 1-year, (17.46)%; 5-year, 1.72%; 10-year, 4.92%.

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

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, 2033, 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.

Risks: In addition to general market conditions, the value of the Fund will be affected by the strength of the real estate markets as well as by interest rate fluctuations, credit risk, environmental issues and economic conditions. The Fund invests in companies of all sizes, including small and medium sized companies whose securities may be thinly traded and more difficult to sell during market downturns.

The discussion of market trends is not intended as advice to any person regarding the advisability of investing in any particular security. The views expressed in this presentation reflect those of the respective speaker. Some of our comments are based on current management expectations and are considered "forward-looking statements." Actual future results, however, may prove to be different from our expectations. Our views are a reflection of our best judgment at the time and are subject to change at any time based on market and other conditions and Baron has no obligation to update them.

The **MSCI USA IMI Extended Real Estate Net Index** is an unmanaged custom index calculated by MSCI for, and as requested by, BAMCO, Inc. The index includes real estate and real estate related GICS classified 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 an unmanaged 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. MSCI is the source and owner of the trademarks, service marks and copyrights related to the MSCI Indexes. The indexes are unmanaged. The index performance is not fund performance; one cannot invest directly into an index.

Portfolio holdings as a percentage of total investments as of September 30, 2022 for securities mentioned are as follows: Vulcan Materials Company, 2.2%.

Top 10 holdings as of September 30, 2022

Holding	% of Net Assets
Brookfield Asset Management Inc.	5.1
CoStar Group, Inc.	4.9
Las Vegas Sands Corporation	4.5
Prologis, Inc.	3.9
American Tower Corp.	3.7
Blackstone Inc.	3.6
Jones Lang LaSalle Incorporated	3.2
CBRE Group, Inc.	3.2
Equinix, Inc.	2.8
Vail Resorts, Inc.	2.8

Portfolio holdings are subject to change. Current and future portfolio holdings are subject to risk.

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