## DEAR BARON REAL ESTATE FUND SHAREHOLDER:

### PERFORMANCE

Baron Real Estate Fund (the "Fund") declined 4.86% (Institutional Shares) in the third quarter of 2022, performing roughly in line with its primary benchmark, the MSCI USA IMI Extended Real Estate Index (the "MSCI Real Estate Index"), which declined 4.99%. The Fund outperformed the MSCI US REIT Index (the "REIT Index"), which fell 10.28%.

Despite a challenging and disappointing 2022, we are pleased to report that as of September 30, 2022, the Fund has maintained its:

- **#1 real estate fund Morningstar ranking for each of its 10-year, 5-year, and 3-year performance periods**
- **5-Star Morningstar Rating™ for each of its 10-year, 5-year, and 3-year performance periods**
- **5-Star Overall Morningstar Rating™**

**We will address the following topics in this letter:**

- Our current top-of-mind thoughts
- Portfolio composition and key investment themes
- Examples of best-in-class real estate companies that are attractively valued
- A review of recent activity managing the Fund
- Concluding thoughts on the prospects for real estate and the Fund

JEFFREY KOLITCH

PORTFOLIO MANAGER

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

**As of 9/30/2022, the Morningstar Ratings™ were based on 234, 206, 150, and 234 share classes for the 3-year, 5-year, 10-year, and Overall periods, respectively. The Baron Real Estate Fund received 5 stars for each period. The Morningstar Ratings are for the Institutional Share Class only; other classes may have different performance characteristics. The Morningstar Ratings are based on the Morningstar Risk-Adjusted Return measures.**

**As of 9/30/2022, the Morningstar Real Estate Category consisted of 253, 234, 206, and 150 share classes for the 1-, 3-, 5-, and 10-year periods. Morningstar ranked Baron Real Estate Fund Institutional Share Class in the 95th, 1st, 1st, and 1st percentiles, respectively. On an absolute basis, Morningstar ranked Baron Real Estate Fund Institutional Share Class as the 243rd, 2nd, 2nd, and 1st best performing share class in its Category, for the 1-, 3-, 5-, and 10-year periods, respectively.**

**As of 9/30/2022, Morningstar ranked Baron Real Estate Fund R6 Share Class in the 95th, 1st, and 1st percentiles, for the 1-, 3-, and 5 year periods, respectively. On an absolute basis, Morningstar ranked Baron Real Estate Fund R6 Share Class as the 242nd, 1st, and 1st best performing share class in its Category for the 1-, 3-, and 5-year periods, respectively.**

**Morningstar calculates the Morningstar Real Estate Category Average performance and rankings using its Fractional Weighting methodology. Morningstar rankings are based on total returns and do not include sales charges. Total returns do account for management, administrative, and 12b-1 fees and other costs automatically deducted from fund assets.**

The **Morningstar Rating™** for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The Morningstar Rating does not include any adjustment for sales loads. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performancefigures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10- year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods.



BARON FUNDS® 1987

# Baron Real Estate Fund

**Table I.**
**Performance**
**Annualized for periods ended September 30, 2022**

| | 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] |
|---|---|---|---|---|
| Three Months[3] | (4.90)% | (4.86)% | (4.99)% | (10.28)% |
| Nine Months[3] | (32.71)% | (32.60)% | (29.94)% | (28.86)% |
| One Year | (26.86)% | (26.68)% | (20.39)% | (17.46)% |
| Three Years | 10.02% | 10.30% | 0.86% | (3.08)% |
| Five Years | 8.08% | 8.36% | 4.17% | 1.72% |
| Ten Years | 10.06% | 10.34% | 8.15% | 4.92% |
| Since Inception (December 31, 2009) (Annualized) | 12.40% | 12.68% | 9.69% | 7.50% |
| Since Inception (December 31, 2009) (Cumulative)[3] | 343.70% | 358.19% | 225.00% | 151.54% |

## Our Current Top-of-Mind Thoughts

**Our expectation for 2022 being a challenging year continues to unfold.**

In our year-end 2021 shareholder letter, we stated that we believed **2022 would be arduous to navigate** in part due to the prospects of a more hawkish Federal Reserve, higher interest rates, and the possibility of moderating growth and valuation compression in segments of commercial and residential real estate.

Additional factors that have contributed to an **unusually challenging investment environment** include the unexpected Russia/Ukraine war and the spillover effects of even higher inflation (food, wheat, crude oil, natural gas), further COVID-19-related lockdowns in China and ongoing supply-chain bottlenecks, and multi-decade high inflation–a portion of which may remain elevated for an extended period (wages and home prices).

These factors have resulted in simultaneous and sharp declines in stocks, bonds, and most investable assets in the first nine months of 2022.

**We remain cautious about the near-term outlook in part due to:**

- Unprecedented and aggressive central bank tightening into a slowing global economy.
- Heightened geopolitical risks (e.g., the recent destruction of the Nord Stream pipelines that were built to carry Russian natural gas to Europe), which may decrease the likelihood of a near-term de-escalation in the Russia/Ukraine war.

**We believe there is reason to be optimistic with a two- to three-year view.**

For much of 2022, **stocks have been repricing for a higher cost of capital, and, more recently, for expectations of slowing growth**. This repricing may continue in the months ahead.

**Though we acknowledge there are valid reasons to remain concerned about the near-term outlook, we believe the shares of many real estate-related companies may benefit from asymmetrical returns in the next two to three years with significantly higher upside.**

Reasons for optimism include:

- Real estate share prices have corrected sharply in the first nine months of 2022–in many cases by 30% to 60%. We believe the correction in share prices for several real estate companies factor in both low valuation multiples or higher capitalization rates and expectations for slower growth.
- Business fundamentals remain strong for many real estate companies, though we do anticipate growth to moderate in the months ahead.
- Corporate and consumer balance sheets are healthy.
- Employment remains a silver lining–there are twice as many job openings as the number of people unemployed.
- Elements of inflation have begun to moderate (e.g., the cost of cars, televisions, airline tickets, home prices, and rents).
- The bulk of the move to higher interest rates may have already occurred.
- China has begun to reopen and rebound from its recent COVID-19 lockdowns and a portion of supply-chain bottlenecks have begun to improve.

*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, 2021 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 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.*

1 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. MSCI is the source and owner of the trademarks, service marks and copyrights related to the MSCI Indexes. The indexes and the Fund include reinvestment of dividends, net of withholding taxes, which positively impact the performance results. The indexes are unmanaged. Index performance is not Fund performance; one cannot invest directly into an index.

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.

- The war in Ukraine will eventually end, which should lead to lower food and energy prices.
- Investor cash balances are at record highs and negative bets on the stock market (shorting) are at levels not seen since 2008 (*Source: J.P. Morgan*).
- Investor sentiment remains fearful and despondent–often a harbinger for strong prospective investment returns.

**We believe the Fund is chock full of real estate stocks that are unsustainably cheap.**

Just as the sharp flight from the stock market in the early days of COVID-19 produced some extraordinary and rare investment opportunities, we believe the correction in real estate share prices in 2022 has also created several compelling investment opportunities.

Real estate companies that we consider **"best-in-class" are rarely valued at discounted prices. We believe now is one of those rare occasions.**

For our more complete thoughts on the valuations of real estate stocks, please refer to "Examples of best-in-class real estate companies that are attractively valued" later in this letter.

**If the economic downturn leads to a recession, real estate will be starting from a good place.**

We always have our antenna up for warning signs in the real estate sector.

In the past, trouble for real estate has surfaced following the excessive use of leverage and overbuilding. This occurred in the 1980s and precipitated the recession in the 1990s and a severe correction in real estate occupancy and rents. The housing crash of 2008 was triggered by cheap credit, lax lending standards, extreme use of leverage, and overbuilding.

Today, real estate is in a good place relative to prior economic slowdowns and recessions.

**In most cases, the use of debt has been disciplined relative to history**. Companies, households, real estate landlords and developers, banks, and other financial institutions generally maintain balance sheets that are liquid with appropriate levels of leverage, fixed-rate debt, and staggered debt maturities. However, this year's spike in interest rates and widening credit spreads are certainly near-term headwinds for commercial and residential real estate.

**Neither commercial nor residential real estate are overbuilt**. Expectations for construction activity are modest due to elevated land, material, and labor costs and expectations for a slowdown in economic growth. If a recession unfolds, we expect declines in commercial occupancy and rents and most residential home prices to be modest and short lived.

Certain segments of real estate can raise prices to provide partial inflation protection–well-located real estate in supply-constrained markets, real estate with short-lease durations, and leases with contractual annual rent escalators.

For several real estate companies, dividend yields continue to grow and are supported by strong cash flows.

**Real estate should be part of a well-diversified investment portfolio.**

We believe real estate should always be a part of a well-diversified portfolio of equities, bonds, and various alternative investments.

In addition to near-term investment merits, the long-term case for real estate remains compelling.

Over time, real estate tends to provide diversification benefits due to low correlations to equities and bonds, inflation protection, and strong long-term return potential.

**We believe the Fund–with the demonstrated merits of our broader, more flexible, and actively managed investment approach–is a highly compelling real estate mutual fund choice.**

## Portfolio Composition and Key Investment Themes

The Fund currently has investments in REITs, plus seven 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 II below).

**Table II.**
**Fund investments in real estate-related categories as of September 30, 2022**

| | | Percent of Net Assets |
|---|---|---|
| REITs | | 27.6% |
| Non-REITs | | 59.3 |
| Building Products/Services | 15.1% | |
| Real Estate Service Companies | 11.3 | |
| Casinos & Gaming Operators | 11.0 | |
| Real Estate Operating Companies | 8.6 | |
| Hotels & Leisure | 5.7 | |
| Homebuilders & Land Developers | 5.2 | |
| Unclassified | 2.3 | |
| Cash and Cash Equivalents | | 13.2 |
| Total | | 100.0%* |

* *Individual weights may not sum to the displayed total due to rounding.*

**A few notable observations regarding the composition of the Fund include:**

*Cash:* We have remained patient and maintained an elevated cash position due to the highly unusual macroeconomic and geopolitical environment and in preparation to capitalize on the emerging opportunity to buy fine companies at highly discounted prices. For the period ended September 30, 2022, cash and cash equivalents stood at 13.2% of the Fund's net assets. We expect we will 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.

*Number of Fund holdings:* Since the middle of last year, we have decreased the number of real estate companies held in the Fund from a peak of 61 companies on June 30, 2021, to 40 companies on September 30, 2022. During this period, we have further prioritized our highest conviction best-in-class real estate companies. Conversely, we have trimmed or exited holdings in certain real estate companies that maintain more leveraged balance sheets, are small and less liquid, or exposed geographically to real estate markets that may face business headwinds.

*Short-lease duration real estate with pricing power:* We have continued to emphasize real estate companies that are able to raise rents and prices on a regular basis to combat inflation. Examples include the Fund's investments in hotel, casino, self-storage, apartment, single-family home rental, and manufactured housing real estate companies.

*Secular growth real estate companies:* Real estate companies that benefit from secular tailwinds where cash flow growth tends to be durable and less sensitive to a slowdown in the economy are a long-term focus of the Fund. Examples include the Fund's investments in wireless tower, data center, industrial logistic, and life science real estate companies.

*Cyclical real estate companies:* Despite expectations for a further slowdown in economic growth and a recession, we are maintaining an allocation to economically sensitive and cyclical real estate companies. The share prices of several of these types of real estate companies have corrected sharply in advance of the economic slowdown and are now attractively valued. Examples include the Fund's investments in certain homebuilding and travel-related real estate companies.

**Investment Themes**

We have continued to prioritize four investment themes or real estate categories:

1. REITs
2. Residential-related real estate companies
3. Other real estate-related companies
4. Travel-related real estate companies

**REITs**

Since the Fund's inception on December 31, 2009, REITs have been an important part of our real estate-related portfolio.

We have tended to limit the Fund's REIT allocation to 25% to 35% of the portfolio so that the Fund is differentiated from most REIT funds.

Business fundamentals and prospects for several REITs remain solid although slower growth is expected in 2023. Balance sheets are in good shape. Several REITs have inflation-protection characteristics. Dividend yields are well covered by cash flow and are growing. The valuations of many REITs are attractive.

Should the contraction in economic growth evolve into no worse than a mild recession and the path of interest rates peaks and begins to decline, the shares of certain REITs may perform relatively well given the contractual nature of cash flows and attractive dividend yields.

We believe the Fund is comprised of compelling REIT companies and categories. A few examples include:

**Technology-centric wireless tower and data center REITs** that we believe have prospects for strong and enduring cash flow growth. Examples: **American Tower Corp.**, **SBA Communications Corp.**, **Equinix, Inc.**, and **Digital Realty Trust, Inc.**

**Residential-related REITs** that provide partial inflation protection given the short duration of leases and solid growth prospects. Examples: **Invitation Homes, Inc.**, **Equity Residential**, **AvalonBay Communities, Inc.**, and **Equity Lifestyle Properties, Inc.**

**Industrial REITs** that we expect to benefit from ongoing robust warehouse demand and increased rents. Examples: **Prologis, Inc.** and **Rexford Industrial Realty, Inc.**

For a more detailed discussion of the investment case for REITs and the various REIT categories, we encourage you to read our September 30, 2022, Baron Real Estate Income Fund shareholder letter.

As of September 30, 2022, the Fund had investments in nine REIT categories representing 27.6% of the Fund's net assets. Please see Table III below.

**Table III.**
**REITs as of September 30, 2022**

| | Percent of Net Assets |
|---|---|
| Industrial REITs | 6.3% |
| Wireless Tower REITs | 5.6 |
| Data Center REITs | 3.1 |
| Single-Family Rental REITs | 2.7 |
| Triple Net REITs | 2.6 |
| Self-Storage REITs | 2.6 |
| Multi-Family REITs | 2.5 |
| Life Science REITs | 1.2 |
| Manufactured Housing REITs | 1.0 |
| Total | 27.6%* |

* *Individual weights may not sum to the displayed total due to rounding.*

**Residential-related real estate companies**

In the first quarter of 2022, we lowered the Fund's exposure to certain residential-related real estate companies (homebuilders, building products/services companies, and home centers) from 23.5% of the Fund's net assets at year-end 2021 to only 11.7% on March 31, 2022.

At that time, we cut the Fund's residential-related exposure because many shares had appreciated significantly over the last few years and were vulnerable to the possibility of an eventual temporary slowdown in housing-related purchase activity due to a combination of consumer affordability concerns driven by the sharp rise in home prices and higher mortgage rates, and a dearth of new housing inventory.

Recent commentary from Stuart Miller, Executive Chairman of **Lennar Corporation**, illuminates the concerns we had at the beginning of 2022. On September 22, 2022, he said the following:

"Housing has now been considerably impacted by the more than doubling of mortgage rates over the past months and therefore, the doubling of monthly payment costs and reduction of housing affordability. The housing market has continued to weaken, as expected, in response to the Fed's too late, but now very rapid and aggressive reaction to inflation. Home building finds itself, once again at the forefront of all that is happening in the economy, and the Fed's use of its interest rate tool to curtail inflation is certainly having the desired effect on the for-sale housing market. The market is now adjusting."

So, what are our current thoughts regarding residential-related real estate companies and their investment prospects?

We expect the sudden and dramatic spike in the 30-year mortgage rate since January 2022 from 3% to 7% on top of a more than 30% increase in home prices since 2020 and their collective impact on housing affordability in addition to the broader deterioration in consumer sentiment, in part due to multi-decade high inflation, will lead to a continuation of the recent homebuyers' "strike" and **significant slowdown in the housing market in the months ahead**.

**We remain long-term bullish on the prospects for the U.S. housing market**. We agree with Toll Brothers' CEO Doug Yearley, who said the following on May 24, 2022:

"The many fundamental drivers of housing demand remain firmly in place. These include favorable demographics, the significant imbalance between the supply and demand for homes, and migration trends. We believe these factors will support a healthy housing market over the long term."

We believe the structural underinvestment in the construction of residential real estate relative to the demographic needs of our country should reverse in the years ahead.

Ever since the housing crisis from 2007 to 2010, housing supply has not kept pace with housing demand, household formation, and population growth leading to a structural shortage of housing. According to the U.S. Census, 12.3 million American households were formed from January 2012 to June 2021, but just 7 million new single-family homes were built during that time. The result? The U.S. is short more than 5 million homes.

A report published by *Evercore ISI Research* on October 4, 2022, further illuminates the constrained inventory of the U.S. housing market:

> "After briefly reaching above 2 million total (housing) starts way back in 2005, the U.S housing industry entered the longest sustained period of under-building since the modern homebuilding industry began in the late 1940s. On a trailing fifteen-year basis, housing starts have averaged just over 1 million annually, well below the industry's 1.5 million long-term average. Since housing starts include both for-sale and rental units, this accumulated shortfall is visible in both record low levels of existing homes for sale and rental vacancy rates. And just as this deficit was more than a decade in the making, it cannot dissipate quickly. Even after a brief rise in inventory this summer, combined with a sharp pullback in sales, homes for sale sit at just 3.2 months, well below the 6.0 months level that is associated with home price declines."

Long-term housing-related demand prospects are also encouraging, especially from the approximately 73 million millennials – ages 25 to 40 – many of whom have been looking to buy or rent a home. Millennials are the largest generation in the workforce–their wages are increasing, and their multi-year delay of household formation is reversing. There are clear signs that millennials are debunking the view that the American Dream to own or rent a home is over.

The large imbalance between pent-up housing demand and low construction levels bodes well, long term, for new single-family home purchases. It also bodes well for home and apartment rentals.

**The stock market is often a discounting mechanism. Sharp increases and decreases in share prices, at times, occur before changes in business fundamentals.**

The shares of homebuilders, building products/services companies, and home centers declined 30% to 50% in the first six months of 2022 even though business fundamentals remained strong. Some of the share prices have continued to decline in the most recent quarter as signs of business weakness have emerged.

At this stage, **we 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 believe homebuilder valuations, currently in the 0.8 to 1.2 times share price to book value range, are cheap and erroneously reflect an expectation for a sharp decrease in home prices which we believe is unlikely in part due to the housing inventory shortfall in the U.S.

Examples of attractively valued residential-related real estate companies are provided later in this letter.

Following the sharp decline in share prices, we have begun to reverse course and increase the Fund's exposure to homebuilders, building products/services companies, and home centers. **Though we expect business conditions to be challenging in the months ahead and growth to moderate, we believe valuations are attractive and the two- to three-year return prospects are compelling.**

As of September 30, 2022, residential-related real estate companies represented 20.3% of the Fund's net assets. Please see Table IV below.

**Table IV.**
**Residential-related real estate companies as of September 30, 2022**

| | Percent of Net Assets |
|---|---|
| Building Products/Services | 12.7% |
| Homebuilders | 5.2 |
| Home Centers | 2.4 |
| Total | 20.3%[1*] |

[1] Total would be 26.5% if included residential-related housing REITs Invitation Homes, Inc., Equity Residential, AvalonBay Communities, Inc., and Equity Lifestyle Properties, Inc.
* *Individual weights may not sum to the displayed total due to rounding.*

### Other real estate-related companies

Our "other real estate-related companies" category includes those companies that do not fit neatly in more traditional real estate categories of REITs, residential-related real estate, and travel-related real estate. Other real estate-related companies currently include:

- Commercial real estate services companies
  Examples: **CBRE Group, Inc.** and **Jones Lang LaSalle Incorporated**
- Real estate-focused alternative asset managers
  Examples: **Brookfield Asset Management Inc.** and **Blackstone Inc.**
- Property technology companies
  Example: **CoStar Group, Inc.**

**Commercial real estate services companies:** We remain bullish on the long-term growth opportunity for the commercial real estate brokerage category because of structural and secular tailwinds that should benefit leading global companies such as CBRE and Jones Lang LaSalle.

Tailwinds include:

- **The outsourcing of commercial real estate**: A growing number of companies are increasingly looking to outsource their commercial real estate needs. CBRE estimates that the overall facilities management market will be $1.9 trillion by 2024, representing a massive growth opportunity for large global commercial real estate services companies.
- **The institutionalization of commercial real estate:** Institutional allocations to real estate continue to increase, in part due to real estate's diversification, inflation protection, and relatively stable long-term growth attributes.
- **Opportunities to increase market share:** The commercial real estate industry remains highly fragmented and is likely to continue to consolidate. Customers tend to prefer commercial real estate companies that can provide a broad set of services. We believe CBRE and Jones Lang LaSalle are best positioned to drive market share gains given that they are the clear #1 and #2 commercial real estate services firms and have the capability to provide the full array of real estate offerings on a global scale.

CBRE and Jones Lang LaSalle have scale, product breadth, and leadership positions across their diversified real estate business segments. They continue to gain market share and are well positioned to capitalize on ample attractive acquisition opportunities in the years ahead given strong and liquid balance sheets. Though we acknowledge that growth in certain segments of their businesses has slowed and is likely to remain pressured in the months ahead due to the global economic slowdown and higher interest rates, we believe both are attractively valued and present compelling return potential in the next few years.

**Real estate-focused alternative asset managers:** We are optimistic about the long-term prospects for Brookfield and Blackstone because we believe both companies are likely to increase market share in a secular growth opportunity for alternative assets.

Institutional allocations to alternative investment assets such as real estate, infrastructure, and private equity are likely to continue to grow significantly in the years ahead because alternatives have a long track record of generating attractive relative and absolute returns with less volatility than several other investment options.

We are bullish on the long-term prospects for Brookfield and Blackstone. Both companies are led by exceptional management teams that attract and retain exceptional talent. They are two of the largest real estate managers in the world with impressive investment track records. Both Brookfield and Blackstone have global franchises, strong brands, and loyal customers.

Following a more than 30% correction in their share prices in the first nine months of 2022, we believe the shares of Brookfield and Blackstone are attractively valued and are optimistic about the long-term potential for the Fund's investments in both companies.

**Property technology companies**: The real estate industry, which represents approximately 13% of U.S. GDP, has eschewed decades of technological innovation while many other industries have evolved rapidly. We are seeing evidence of that trend beginning to change as real estate companies are increasingly adopting technology as a source of competitive differentiation and evolution across property sectors.

This collision of real estate and technology has led to a new sub-industry within real estate–real estate technology, also referred to as *proptech*. Proptech is the usage of technology and software to assist in meeting real estate needs.

The emergence of proptech and the digitization of real estate is an exciting and promising new development for real estate. We believe we are in the early innings of a technology-driven investment cycle centered on data and digitization that allows real estate-related businesses to drive incremental revenue streams and lower costs.

CoStar, a top holding in the Fund, is well positioned to capitalize on this burgeoning secular growth trend.

CoStar is the leading provider of information, analytics, and marketing services to the real estate industry. CoStar initially focused on serving the domestic commercial real estate industry and built a comprehensive proprietary database of essential data to help participants buy, sell, and lease properties. The company has since expanded its focus to offer products and services to multi-family, industrial, commercial land, mixed-use and hospitality end-markets across North America and Western Europe.

Today, the company's non-residential operations generate over $2 billion of recurring revenue with cash flow (EBITDA) margins above 40%. We expect this business to grow its revenue at a mid-teens rate for several years as the company launches new products, upsells existing customers, and raises prices. We expect profit and cash flow to grow at an even faster rate given the low marginal costs inherent in CoStar's business model. We think that cash flow from this business can double over the next five years, which implies a similar return for the stock.

The company undertook an audacious expansion plan in 2021, when it committed to invest almost $300 million per year to enter the domestic residential real estate market. The stock initially declined significantly as investors fretted over the significant added expense to pursue this opportunity. We view the investment as nominal relative to CoStar's $3.7 billion net cash balance and significant annual free cash flow generation capability. We think that the residential market is vast, and that CoStar is well positioned to build a compelling and differentiated business serving this market. If successful, we think that CoStar could generate almost $1 billion of incremental revenue over the next 5 to 10 years. If unsuccessful, CoStar can easily throttle back on its investment and redeploy resources towards other markets without having impacted the fundamentals of its business.

Based on the current valuation of its shares and our expectation for future growth, we believe CoStar's shares have the potential to appreciate by 100% in the next three to four years.

As of September 30, 2022, other real estate-related companies represented 22.2% of the Fund's net assets. Please see Table V below.

**Table V.**
**Other real estate-related companies as of September 30, 2022**

| | Percent of Net Assets |
|---|---|
| Real Estate-Focused Alternative Asset Managers | 8.6% |
| Property Technology Companies | 7.2 |
| Commercial Real Estate Services Companies | 6.4 |
| Total | 22.2%* |

* *Individual weights may not sum to the displayed total due to rounding.*

**Travel-related real estate companies**

At the beginning of this year, we were bullish about the prospects for the Fund's investments in travel-related real estate companies. We felt that 2022 and 2023 would be a period in which more than two years of COVID-19-related pent-up demand would be unleashed for leisure and business travel.

Though travel-related business fundamentals have been strong for most of 2022, we tempered our enthusiasm for travel-related real estate companies over the course of this year because of the onset of unexpected developments and headwinds. They include the war in Ukraine, high inflation (gas/fuel prices, airline tickets, hotel room prices, food prices, housing), and the possibility of a sharp economic slowdown, which may negatively impact consumer discretionary spending for leisure and business travel in the next 12 to 18 months.

In the second quarter, we lowered the Fund's exposure to travel-related real estate companies (casinos & gaming operators, hotels, timeshare operators, amusement park operators, other leisure companies, and online travel agencies) from 35.3% to 16.4% and have kept the Fund's travel-related exposure at approximately this level through the end of the third quarter.

We continue to maintain an allocation to certain travel-related real estate companies for the following reasons:

- We believe the valuations of several travel-related real estate companies are highly discounted relative to their intrinsic value and offer excellent investment return prospects in the next two to three years. Please refer to "Examples of best-in-class attractively valued real estate companies" later in this letter.
- Certain travel-related businesses remain cyclically depressed not secularly challenged and should rebound as economic strength re-emerges. For example, the business operations of Macau-centric casino and gaming companies such as **Las Vegas Sands Corporation** have yet to recover due to the ongoing COVID-19 challenges in China. We expect business to rebound sharply when economic growth recovers just as it did in Las Vegas.
- The Fund's investments in travel-related real estate companies maintain well-capitalized and liquid balance sheets and should be able to comfortably withstand any slowdown in economic growth just as they did during the early days of COVID-19.
- We remain bullish about the long-term spending priorities of consumers. In fact, we believe consumers are resilient. The millennial generation (72 million people), for example, continues to prioritize experiences such as travel more so than spending on goods–and posting these experiences on social media!
- Private equity companies such as Blackstone have a long history of investing in travel-related companies and have continued to highlight the travel segment as an important investment priority. Given the highly discounted share prices and valuations of certain travel-related companies, we would not be surprised if private equity firms take advantage of the favorable valuation arbitrage between the public and private market and acquire public travel companies.

As of September 30, 2022, travel-related real estate companies represented 16.7% of the Fund's net assets. Please see Table VI below.

**Table VI.**
**Travel-related real estate as of September 30, 2022**

| | Percent of Net Assets |
|---|---|
| Casinos & Gaming Operators | 11.0% |
| Ski Resorts | 2.8 |
| Timeshare Operators | 1.9 |
| Hotels | 1.1 |
| Total | 16.7%[1*] |

[1] Total would be 18.1% if included travel-related gaming REIT Gaming and Leisure Properties, Inc.
* *Individual weights may not sum to the displayed total due to rounding.*

## Examples of Best-in-Class Real Estate Companies That are Attractively Valued

In our judgment, 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
- Employs an intelligent and motivated management team that is an excellent allocator of capital and has interests aligned with shareholders

Our view is that special "best-in-class" real estate companies should generate superior returns over the long term.

In this year's stock market correction, few companies have been spared. The sharp decline in stocks has been broad based and has included competitively advantaged best-in-class real estate companies, many of which are now trading at attractive valuations.

Several best-in-class real estate companies are "on sale" relative to history <u>and</u> relative to private real estate alternatives. We believe the favorable arbitrage between public and private real estate valuations bodes well for the return prospects of public real estate companies in the next few years.

The Fund is chock full of best-in-class companies that are "on sale." Examples include:

**REITs**

**Invitation Homes, Inc.** is the largest institutional owner of single-family rental homes concentrated across high-growth markets and in-fill neighborhoods with access to good schools, transportation corridors, and robust employment opportunities.

It is valued at an implied capitalization rate basis of 5.2% versus private market transactions in the 4% capitalization range. The public market implied valuation of its owned homes is only $360,000 per home versus acquisition costs of approximately $440,000 per home.

**Equity Residential** is the largest U.S. apartment REIT with 80,000 high-quality apartment units concentrated in coastal markets with strong barriers to entry, compelling resident income/demographics, and high cost of home ownership. The company maintains a strong and liquid balance sheet.

It is valued at a 5.2% implied capitalization rate representing a discount to private market transactions in the 4% capitalization range. At its public market implied valuation of only $450,000 per apartment, its shares are valued at more than a 25% discount to private market values.

**Equinix, Inc.** is the premier global carrier and cloud-neutral data center operator with 250 data centers in 70 metropolitan areas and 30 countries.

Equinix is currently valued at under 20 times cash flow versus recent private market data center transactions that have occurred at 25 to 30 times cash flow. The shares are valued at a similar multiple to REITs broadly despite superior and more durable cash flow growth prospects.

**Prologis, Inc.** is the world's largest industrial REIT. The company owns a high-quality real estate portfolio that is concentrated in major global trade markets and large population centers across the Americas, Europe, and Asia. Prologis has an unmatched global platform, strong competitive advantages (scale, data, and technology), and attractive embedded growth prospects. The company is the only industrial REIT with an 'A' credit rating.

Following a year-to-date decline in its shares of approximately 40%, we believe Prologis' current valuation of only 22 times cash flow (adjusted funds from operations or "AFFO") and a 4.6% implied capitalization rate is compelling given that the company's rents on its in-place leases are more than 50% below current market rents, thus providing a strong runway for growth in the next three to five years.

**Public Storage Incorporated** is the world's largest owner, operator, and developer of self-storage facilities. Public Storage has achieved the #1 market position in 14 of its top 15 markets and is widely recognized as the leading self-storage company with the premier brand.

It is currently valued at a 5.6% capitalization rate or a 25% discount to its estimated net asset value.

**Alexandria Real Estate Equities, Inc.** is the leading landlord and developer for the life science industry. A best-in-class company with several competitive advantages including an irreplaceable life science office portfolio concentrated in the premier life science markets in the U.S. and deep customer relationships.

Alexandria is valued at a 5.8% implied capitalization rate versus recent life science real estate transactions that have been valued in the 4% to 5% capitalization range. Alexandria's real estate is attractively valued at approximately $600 per square foot versus private market transactions for life science real estate in the $1,000 to $1,500 per square foot range.

**Residential-Related Real Estate Companies**

**Lennar Corporation** is the second-largest U.S. homebuilder with competitive scale advantages (including materials procurement and labor), an increasingly capital-light business model, a strong balance sheet, a strategic and forward-looking focus on technology investments, and an exceptional management team.

It is valued at only 1.0 times tangible book value versus its more typical historical valuation range of 1.5 to 2.5 times tangible book value.

**Toll Brothers, Inc.** is a leading luxury homebuilder in the U.S. with a highly capable management team and a large, valuable owned land real estate portfolio.

The company is valued at only 0.9 times tangible book value versus its long-term average of approximately 1.4 times book value and a peak multiple of approximately 2.0 times tangible book value.

**Lowe's Companies, Inc.** is the second-largest home improvement center in the U.S. The company has several competitive advantages including scale, distribution efficiencies, interconnected retail through stores/internet, excellent management, and a strong balance sheet.

The company is valued at only 14 times estimated earnings per share versus its long-term average P/E multiple of approximately 18 times estimated earnings per share.

**Fortune Brands Home & Security, Inc.** is a leading manufacturer of home security products, which include kitchen and bath cabinetry, plumbing and accessories, entry door systems, and security products. The company has several competitive advantages, including recognizable brands, a focus on innovation, strong distribution relationships, and a proven and highly capable management team.

It is valued at only 8 times 2023 estimated cash flow versus a historical valuation range of 9 to 14 times cash flow.

**Trex Company, Inc.** is the largest manufacturer (#1 by market share) of wood-alternative (composite) outdoor decking and railing in the U.S. The company has the most well-regarded consumer brand, an exclusive distribution footprint, and proprietary recycling expertise that gives it cost advantages.

Following a nearly 70% decline in its shares in the first nine months of 2022, Trex is valued at a steep discount to its historical range of valuation multiples.

**Floor & Decor Holdings, Inc.** is a leading and high-growth specialty retailer of hard-surface flooring. The company offers the lowest prices and the broadest differentiated in-stock selection of tile, wood, laminate, and other flooring options and has highly compelling long-term growth prospects.

The company's shares are currently valued at only 24 times 2023 estimated earnings per share versus its historical range of 25 to 50 times earnings per share.

**SiteOne Landscape Supply, Inc.** is the only national wholesale distributor of landscape supplies. The company is more than five times the size of its next closest competitor and has many opportunities to make acquisitions and consolidate a highly fragmented industry.

The company is currently valued at only 13 times cash flow versus its historical valuation range of 15 to 20 times cash flow prior to COVID-19.

**Other Real Estate-Related Companies**

**Brookfield Asset Management Inc.** is a leading global alternative asset manager and operator that is one of the largest owners and operators of real estate and infrastructure assets in the world.

It is currently valued at more than a 50% discount to management's assessment of the company's current value. At the company's September 2022 Investor Day, Brookfield's management team laid out a multi-year growth plan with expectations for its shares to increase from its recent price of only $40 to more than $175 over the next five years.

**Blackstone Inc.** is the world's largest alternative asset manager with $1 trillion in assets under management and the largest real estate manager in the world. Blackstone has a premier brand, a global franchise, loyal customers, an exceptional balance sheet, and an excellent management team.

It is currently valued at a modest premium to the S&P 500 Index multiple despite far superior long-term growth prospects. The company's current dividend yield is 6.1%.

**CBRE Group, Inc.** is the largest commercial real estate services firm in the world. It maintains a #1 worldwide market share position in each of its key business lines and has a pristine balance sheet.

It is currently valued at only 13 times estimated 2023 earnings per share versus a long-term average valuation multiple of 15 to 16 times earnings per share.

**Jones Lang LaSalle Incorporated** is one of the leading commercial real estate services firms in the world with scale, product breadth, and leadership positions across its diversified real estate business segments.

It is currently valued at only 8 times estimated 2023 earnings per share versus a long-term average of 14 times earnings per share.

**Travel-Related Real Estate Companies**

**MGM Resorts International** is a leading global casino and entertainment company with 29 unique hotels and casinos including some of the most recognizable resort brands such as Bellagio, MGM Grand, ARIA, and Park MGM.

At its recent price of only $30 per share, we believe MGM's valuation is compelling at only 6 times 2023 estimated cash flow.

**Red Rock Resorts, Inc.** is a leading real estate casino gaming company that owns and operates 100% of its real estate assets. The majority of the company's cash flow is generated in the Las Vegas Locals market, a real estate market that possesses highly favorable long-term demand and supply prospects. The company has capacity to double the size of its business in the next five to seven years and maintains a strong balance sheet. Insiders own more than 40% of the company.

With shares valued at only 8 times 2023 estimated cash flow (EBITDA) and a double-digit free cash flow yield, we think Red Rock's share price is compelling.

**Vail Resorts, Inc.** owns and operates a premier portfolio of mountain resorts including marquee resorts such as Vail, Beaver Creek, Breckinridge, Park City, Whistler Blackcomb, and Keystone.

Vail's shares have declined 43% from a peak of $376 in November 2021 to a recent price of only $215 and are currently valued at only 11 times cash flow versus its long-term average multiple of approximately 15 times cash flow.

## A Review of Recent Activity Managing the Fund

In the third quarter, we maintained our active approach managing the Fund due to:

- The emergence of tailwinds and headwinds in certain segments of real estate
- Company-specific considerations
- Unusually elevated stock market volatility

We believe our action steps continue to position the Fund for strong long-term performance.

**Table VII.**
**Top net purchases for the quarter ended September 30, 2022**

| | Quarter End Market Cap (billions) | Amount Purchased (millions) |
|---|---|---|
| Prologis, Inc. | $75.2 | $21.4 |
| Netstreit Corp. | 1.1 | 17.3 |
| SBA Communications Corp. | 30.7 | 13.2 |
| Rexford Industrial Realty, Inc. | 8.9 | 11.6 |
| Pool Corporation | 12.6 | 11.0 |

In the third quarter, we acquired additional shares of **Prologis, Inc.**, the world's largest industrial REIT. We are big fans of CEO Hamid Moghadam and Prologis' management team and remain optimistic about the company's long-term growth prospects.

The company owns and operates a premier global real estate portfolio with several competitive advantages including location, scale, data, and technology. Management maintains a strong and liquid balance sheet and is the only U.S. industrial REIT with an 'A' credit rating, which gives the company a strong borrowing cost advantage. With vacancy at less than 4% and rents on in-place leases that are more than 50% below current market rents, Prologis has a compelling runway for strong growth in the next three to five years.

We are optimistic about the merits of the company's recently closed merger with its largest industrial REIT competitor, Duke Realty. Duke's industrial portfolio is among the best in industrial real estate. The company has an excellent track record in development and construction. We believe the merger has strategic and financial merits including acquiring a high-quality portfolio in mostly similar or attractive real estate markets and the likelihood of realizing both additional revenue and cost savings.

Following the steep correction in its shares in the first nine months of 2022, we believe Prologis is attractively valued at only 18 times cash flow (AFFO) or a 4.5% capitalization rate. These metrics reflect modest premiums to the REIT index despite Prologis' superior long-term growth prospects.

We recently initiated a position in **Netstreit Corp.**, a triple net REIT that acquires, owns, and manages a diversified portfolio of single-tenant, net lease retail commercial real estate with high credit quality tenants. We have a favorable view of management and its plan to continue to grow the company rapidly through accretive acquisitions.

Led by CEO Mark Manheimer, management has assembled a high-quality real estate portfolio with more than 80% of the portfolio consisting of investment grade tenants or tenants with an investment grade profile. During the COVID-19 lockdown, the company preserved an excellent rent collection rate and maintained 100% occupancy through all of 2020 and 2021.

The company's strong balance sheet, with leverage of only 3.7 times cash flow (adjusted for a recent equity capital raise) and ample liquidity, should allow management to pursue accretive acquisitions, which would likely lead to strong earnings growth in the next few years.

In the most recent quarter, we acquired additional shares in **SBA Communications Corp.**, a U.S.-centric tower company with 35,000 total communication sites globally and 17,000 in the U.S. The company derives approximately 80% of its cash leasing revenue in the U.S. with the balance coming from international markets (mainly Brazil). We have known CEO Jeff Stoops for over 15 years and have high respect for him and the broader executive management team after carefully observing their capital allocation decisions over many years.

We believe the company is well positioned to benefit from secular growth drivers including strong mobile data growth and the adoption of fifth generation mobile network (5G), which will enable future applications (e.g., autonomous cars, augmented reality, 3D video) that are even more data-intensive than the applications that exist today. We believe SBA can deliver double-digit annual cash-flow-per-share growth each of the next few years through organic growth, 5% to 10% portfolio growth (acquisition and development), and by reinvesting in its own towers via share repurchases.

We recently acquired additional shares in **Rexford Industrial Realty, Inc.**, a high-growth real estate investment trust that owns a $13 billion portfolio of infill industrial properties concentrated in Southern California. We are optimistic about the long-term prospects of Rexford to grow cash flow at a rapid pace and generate attractive shareholder returns.

Southern California is among the most attractive markets for industrial real estate in the country, owing to the diverse set of industries that drive demand for warehouse space, and new infill development activity that is limited by a scarcity of developable land and "higher and better use" opportunities to develop land for purposes other than warehouse space.

Rexford is growing rapidly, both organically (record occupancy, rising market rents, contractual rent escalators in leases) and through acquisitions in a highly fragmented market. Rexford's current portfolio rents are on average over 50% below market rents, which should drive outsized organic growth over the next several years as in-place leases expire and reset to market rates. In addition, we expect Rexford to continue to rapidly grow its market share (currently less than 2%) through acquisitions.

Following a more than 35% correction in its shares in the first nine months of 2022, we believe the company's valuation is attractive relative to the high-quality nature of the platform and the significant growth we expect to see over the next several years.

**Pool Corporation** is the world's largest distributor of swimming pool supplies, equipment, and related leisure products and is also one of the top three distributors of irrigation and landscape suppliers in the U.S. The company sells over 200,000 products from over 2,200 suppliers to over 120,000 professional contract and retailer customers through its 400-plus sales centers across 12 countries, with 70% of its transactions occurring in person. Within its core pool category, Pool has strong market share and is bigger than its next fifty competitors combined, giving Pool a strong scale advantage and allowing the company to invest in its products, technology, customer service, and supply chain to differentiate itself. Over 60% of Pool's revenues come from maintenance and repair of existing pools, providing Pool with a large and growing recurring revenue base as more pools are built each year.

Pool has a long history of delivering organic and inorganic growth supported by the recurring nature of most of its revenues while consistently taking market share each year. We believe management will continue to deliver on its growth targets as the company today benefits from favorable U.S. population migration trends and demographic shifts (de-urbanization, southern migration), an aging pool installed base, an increasing number of new features, and technology content both in and around the pool. Pool also recently acquired Porpoise Pool & Patio, which includes a retail store franchise business and chemical packaging operation, enabling new sales and margin growth opportunities for the business.

As the stock sold off on fears of a housing-related slowdown in the pool industry, we accumulated additional shares of this best-in-class company as we believe the current share price is attractive relative to the long-term growth opportunity and value of the business.

**Table VIII.**
**Top net sales for the quarter ended September 30, 2022**

| | Quarter End Market Cap or Market Cap When Sold (billions) | Amount Sold (millions) |
|---|---|---|
| Ventas, Inc. | $19.4 | $21.2 |
| Digital Realty Trust, Inc. | 29.1 | 18.6 |
| CBRE Group, Inc. | 21.7 | 16.6 |
| AvalonBay Communities, Inc. | 25.8 | 16.4 |
| Equity Residential | 25.3 | 15.8 |

In the third quarter, we reduced the Fund's REIT exposure by exiting health care REIT **Ventas, Inc.**, and trimming the Fund's holdings in data center REIT, **Digital Realty Trust, Inc.** and apartment REITs, **AvalonBay Communities, Inc.** and **Equity Residential.** We reallocated the capital to non-REIT real estate companies that we believe offer superior return prospects.

In the most recent quarter, we trimmed the Fund's position in **CBRE Group, Inc.**, the largest commercial real estate services firm in the world. Though we believe segments of its business are currently facing headwinds (e.g., leasing and property sales), we remain bullish on the long-term growth prospects for CBRE. CBRE has scale, product breadth, and leadership positions across its diversified real estate business segments. The company continues to gain market share and is well positioned to capitalize on ample attractive acquisition opportunities in the years ahead given its strong and liquid balance sheet.

Though near-term growth in certain segments of its business is likely to moderate in the months ahead due to the global economic slowdown and higher interest rates, we believe CBRE shares are now attractively valued and present compelling return potential over the next few years.

**Table IX.**
**Top contributors to performance for the quarter ended September 30, 2022**

| | Quarter End Market Cap (billions) | Percent Impact |
|---|---|---|
| CoStar Group, Inc. | $ 28.3 | 0.50% |
| Las Vegas Sands Corporation | 28.7 | 0.41 |
| Vulcan Materials Company | 21.0 | 0.20 |
| Floor & Decor Holdings, Inc. | 7.5 | 0.18 |
| Lowe's Companies, Inc. | 116.6 | 0.16 |

The shares of **CoStar Group, Inc.** performed well in the third quarter following strong quarterly business results. The company is the leading provider of information, analytics, and marketing services to the real estate industry. Based on the current valuation of its shares and our expectation for future growth, we believe CoStar's shares have the potential to appreciate by 100% in the next three to four years. A more complete discussion of CoStar can be found earlier in this letter in the "Portfolio Composition and Key Investment Themes" section.

The shares of **Las Vegas Sands Corporation** performed well in the most recent quarter in part due to the decision by China's central government to ease the visa policy for Macau, which should result in increased travel into Macau for the first time since the outbreak of COVID-19.

Sands is a global leader in the development and operation of luxury casino resorts in Macau and Singapore, and it maintains a liquid and investment grade balance sheet. We anticipate that management may begin to return capital to shareholders through dividends and share buybacks as Singapore and Macau recover.

The shares are valued at a significant discount to our assessment of replacement cost, and the company's Macau operations are valued at only 7 times estimated cash flow.

The shares of **Vulcan Materials Company** increased 11% in the most recent quarter in part due to strong quarterly business results and expectations for solid growth in the next few years.

Vulcan is a real estate-related company that is the largest construction aggregates producer in the U.S.

Vulcan generates approximately 90% of its gross profit from mining, processing, and transporting crushed stone, sand, and gravel (collectively, "aggregates") from its quarries. The balance of its gross profit is derived from ready-mix concrete and asphalt. The company's products are sold and utilized in infrastructure projects such as highways, as well as residential and non-residential construction.

We believe aggregates are an attractive business for three reasons:

1. *High barriers to entry:* Permits to open new quarries are difficult to obtain, and the approval process typically takes 5 to 10 years.

2. *Consistent pricing power*: Given the difficulty in opening competing new quarries, and the transportation constraints attributable to the heavy weight of rocks, the producers of aggregates have historically enjoyed great pricing power. In the last 30 years, pricing of aggregates has increased, on average, 4% per year.

3. *Preponderance of local monopolies primarily due to the steep transportation costs of this heavy-weight cargo:* Therefore, the sale of heavy rock is primarily a local business, and quarry location is a key determinant of value. Vulcan is entrenched and very well positioned, as it owns 344 aggregate facilities across the U.S.

In our view, the long-term growth prospects for Vulcan are attractive. In the near term, government spending on infrastructure is expected to accelerate. Longer term, we expect residential and non-residential construction to reaccelerate.

Following a sharp decline in its shares in the first six months of 2022 and strong third quarter earnings results, the shares of **Floor & Decor Holdings, Inc**. performed well in the most recent quarter. The company is a leading and high-growth specialty retailer of hard-surface flooring offering the industry's broadest in-stock selection of tile, wood, laminate, vinyl, and natural stone flooring.

We are optimistic about the long-term, multi-pronged growth prospects for the company. They include the potential to grow its store count in the U.S. from 153 stores to more than 400 stores, strong comparable store sales growth, growth in the company's online business, growth opportunities with professional and commercial customers and designer services. The company is also well positioned to benefit from the cyclical and secular tailwinds that should aid the U.S. housing market in the years ahead. At its recent price of only $71, we believe the shares are attractively valued.

The shares of **Lowe's Companies, Inc.** increased 7% in the most recent quarter following better better-than-expected quarterly business results. Lowe's is the second largest home improvement center in the U.S. The company has several competitive advantages including scale, distribution efficiencies, interconnected retail through stores/internet, excellent management, and a strong balance sheet.

We believe the shares are attractively valued at only 14 times estimated earnings per share versus a long-term average P/E multiple of approximately 18 times estimated earnings per share.

**Table X.**
**Top detractors from performance for the quarter ended September 30, 2022**

| | Quarter End Market Cap (billions) | Percent Impact |
|---|---|---|
| Prologis, Inc. | $ 75.2 | –0.69% |
| American Tower Corp. | 100.0 | –0.64 |
| Brookfield Asset Management Inc. | 63.8 | –0.53 |
| Equinix, Inc. | 51.8 | –0.38 |
| Jones Lang LaSalle Incorporated | 7.2 | –0.37 |

In the third quarter, concerns about a global economic slowdown, elevated inflation, and rising interest rates pressured the shares of several of our favorite long-term holdings despite strong long-term growth prospects. See Table X. We remain optimistic about the long-term prospects for each of these companies and may look for opportunities to acquire additional shares.

## Concluding Thoughts on the Prospects for Real Estate and the Fund

We are mindful that this year's repricing of the stock market and real estate securities has been unpleasant and may continue in the months ahead as economic growth slows and company growth forecasts are lowered.

Yet, we believe this year's recalibration is setting the stage for a favorable multi-year outlook for public real estate companies and the Fund.

Many public real estate companies now offer compelling two- to three-year return prospects that, in some cases, may include a trifecta combination of growth, dividends, and an improvement in valuation.

We are optimistic about the prospects for the Fund, because we believe we have assembled a portfolio of best-in-class competitively advantaged real estate companies with compelling long-term growth and share price appreciation potential.

# Baron Real Estate Fund

**Table XI.**
**Top 10 holdings as of September 30, 2022**

| | Quarter End Market Cap (billions) | Quarter End Investment Value (millions) | Percent of Net Assets |
|---|---|---|---|
| Brookfield Asset Management Inc. | $ 63.8 | $63.3 | 5.1% |
| CoStar Group, Inc. | 28.3 | 61.2 | 4.9 |
| Las Vegas Sands Corporation | 28.7 | 56.1 | 4.5 |
| Prologis, Inc. | 75.2 | 48.8 | 3.9 |
| American Tower Corp. | 100.0 | 46.5 | 3.7 |
| Blackstone Inc. | 100.3 | 44.8 | 3.6 |
| Jones Lang LaSalle Incorporated | 7.2 | 39.8 | 3.2 |
| CBRE Group, Inc. | 21.7 | 39.8 | 3.2 |
| Equinix, Inc. | 51.8 | 35.6 | 2.8 |
| Vail Resorts, Inc. | 8.7 | 35.2 | 2.8 |

I thank you, our loyal shareholders, and express my utmost gratitude for your past and continuing support of the Fund.

Sincerely,

Jeffrey Kolitch
Portfolio Manager

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*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 the Funds' 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 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 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.

The portfolio manager defines "**Best-in-class**" as well-managed, competitively advantaged, faster growing companies with higher margins and returns on invested capital and lower leverage that are leaders in their respective markets. Note that this statement represents the manager's opinion and is not based on a third-party ranking. **Price/Earnings Ratio** (next 12-months): is a valuation ratio of a company's current share price compared to its mean forecasted 4 quarter sum earnings per share over the next twelve months. If a company's EPS estimate is negative, it is excluded from the portfolio-level calculation.

BAMCO, Inc. is an investment adviser registered with the U.S. Securities and Exchange Commission (SEC). Baron Capital, Inc. is a broker-dealer registered with the SEC and member of the Financial Industry Regulatory Authority, Inc. (FINRA).