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## Baron Energy and Resources Fund

# A Different Approach to Investing in Energy

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**Portfolio Manager**

With oil and gas prices dropping in the third quarter, and investors once again rotating out of the energy sector, it may seem like an odd time to be writing about the Baron Energy and Resources Fund. In fact, for a number of reasons, we think this is the ideal time to provide an update on the Fund, its portfolio and strategy, and the energy industry.

Unlike most of our peers, the performance of our Fund is not highly correlated to commodity prices. It is our belief that oil and natural gas prices will remain seasonally volatile, but relatively non-inflationary in the next several years. This price-neutral environment, we believe, favors equities over commodities and should also favor stock selection over indexing. We have structured and actively manage our Fund with these ideas in mind, and we believe we offer our investors better growth opportunities and performance that is less closely tied to commodity prices – or its benchmarks – than more traditional energy funds.

We launched the Baron Energy and Resources Fund in late 2011, with veteran energy investor and analyst Jamie Stone as portfolio manager. Baron has always invested in energy companies, and our goal was to provide a more focused investment opportunity in an area that had contributed positively to the performance of our non-sector Funds. As with all of our investments, we take a long-term approach to investing in energy and resources companies, informed by our exhaustive, bottom-up research that focuses on companies with excellent growth prospects, exceptional management, and significant competitive advantages, at appropriate valuations.

We are pleased to report that the Fund has significantly outperformed its benchmark since inception, for the trailing 12 months, and year-to-date.

### Performance vs benchmark as of 9/30/14

| Performance | Baron Energy and Resources Fund* | S&P North American Natural Resources Sector Index |
|---|---|---|
| **Annualized since inception**** | 10.47% | 8.36% |
| **One year** | 15.96% | 10.27% |
| **Year-to-date***** | 10.41% | 4.75% |

*Institutional Shares
**12/30/11
***Not annualized

*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; redeemed shares may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted above. For performance information for the most recent month end, visit www.BaronFunds.com or call 1-800-99BARON. The Adviser has reimbursed certain Fund expenses, and transfer agency expenses may be reduced by offsets from an unaffiliated transfer agent, without which performance would have been lower. Performance is net of annual operating expenses. As of 12/31/2013, Fund expenses were 2.84% total and 1.10% net of the Adviser's fee waivers.*

The indexes are unmanaged. The S&P North American Natural Resources Sector Index measures the performance of U.S.-traded natural resources-related stocks. The Index and the Fund are with dividends, which positively impact performance results. Performance data does not reflect the deduction of taxes.

The Baron Energy and Resources Fund takes a different investment approach than the typical energy fund. Four characteristics help to differentiate the Fund from its peers.

1. **No integrated oil & gas stocks** Perhaps most notably, the Fund has zero weighting in the integrated oil & gas sub-industry. This sub-industry, which is composed of just 4 of the 44 energy companies in the S&P 500, comprises some 44% of the energy sector market cap. Given the close correlation of the integrated oil & gas sub-industry share prices with commodity prices, our lack of exposure to this group is one of the reasons our Fund's performance tends not to track the price of commodities. Since inception, the Fund's R-Squared, which measures correlation to an index, is just 29.8% to the price of oil and less than 1% to the price of natural gas. In addition, we believe that the integrated oil and gas companies are growth challenged over at least the next 3-5 years.

2. **Focus on growth** The Fund invests in growth stocks, which distinguishes us from the value-centric approach of many of our peer funds. Although energy is considered a mature industry, we see numerous opportunities for select companies to generate significant growth, including U.S. shale production, transportation and processing infrastructure, deepwater oilfields, and alternative/renewable energy, among others. We believe that the growth companies in these areas in which we have invested have the potential to deliver superior shareholder returns over a longer period of time, and the performance of our Fund over the last year and since inception supports this view.

3. **All cap portfolio with smid cap emphasis** Unlike the large cap focus of most energy funds, we look for growth companies across all capitalizations, with an emphasis on small to mid cap companies, primarily because that is where we have found the most promising growth opportunities. Our current holdings range in size from **Halliburton Co.'s** $54.9 billion market cap to **Lekoil, Ltd.'s** $400 million market cap, with a median market cap of $3.4 billion. About 19% of the Fund is invested in large cap companies with capitalizations over $10 billion, about 37% is invested in the $2.5 billion to $10 billion mid-cap space, and about 37% is invested in small cap companies with capitalizations below $2.5 billion.

4. **Active management, lower turnover** We actively manage the portfolio, building it one stock at a time, based on our fundamental research and long-term investment approach and without regard to sector or sub-industry weightings. The Fund has lower turnover than many of its peers (22.13% two-year average, vs. 66.50%). With 50-60 securities at any given time, the Fund is also more concentrated that most of the bigger energy funds.

To find growth in a mature industry, we first seek to identify the drivers of differentiated growth, and then we identify, research and value the companies that we think are best positioned to benefit. Over the past several years, our research has led us to focus primarily on the exploration and production, oilfield equipment and services, and storage and transportation sub-industries within energy, as well as, most recently, alternative/renewable energy. Energy has historically been a long-cycle business, and we believe we are still in the early stages of an extended growth cycle based on the drivers we have identified.

## The Shale Revolution

We believe the most significant wealth creation opportunity in energy today lies with the conversion of unconventional resources in North America – in particular, shale and other "tight" reservoirs – into reserves and cash flow growth. Evolutionary developments in the use of horizontal drilling and hydraulic fracturing technologies are now enabling the production of large quantities of oil and gas from shale basins in the U.S. and Canada. As a result, in the past five years, most of the growth in global production has been out of North America, with the rest of the world lagging. This is a reversal of the prior two decades, and can be linked directly to a shift in capital allocation to the U.S. and Canada and away from the rest of the world.

We are investing in this theme through exploration & production companies and oilfield service and equipment companies, which we will touch upon here, and Master Limited Partnerships (MLPs) and other infrastructure-related companies, which we discuss in the next section.

In exploration and production, we look for companies with core acreage positions and experienced management teams who we believe have the financial and technical expertise to deliver strong production. We have found these attributes to be the key to differentiated growth and returns on investment, which in turn, help drive up share prices. We also focus primarily on small to mid cap companies in this area, as economies of scale are not as important as the potential rate and durability of growth. Two of our current favorite exploration and production companies are **Bonanza Creek Energy, Inc.** and **Concho Resources, Inc.**, which we have held since the inception of the Fund. Newer investments in this area include **Parsley Energy, Inc.** and **RSP Permian, Inc.**, two companies operating in the Permian Basin in West Texas, which we think may prove to be the dominant shale play in the U.S.

The energy frontiers of today are far more capital intensive than their predecessors. The days of "shootin' at some food and hitting bubblin' crude" are long gone. Both unconventional/shale and deepwater drilling operations require much more technical expertise, engineering, equipment and construction to unlock and develop these new energy reserves. We believe that oil & gas equipment & services companies are ideally positioned to benefit from the ongoing acceleration in U.S. drilling and completion activities. Unlike the majority of our peers, we

have significant exposure in this area, including three of our top ten holdings: **Halliburton, Flotek Industries, Inc.** (classified as Materials although its business is based on oilfield activity), and **Forum Energy Technologies, Inc.**

## MLPs and Other Infrastructure Stocks

The development of unconventional resources in new geographies across North America is creating significant demand for processing, storage, and transportation infrastructure to move product to market. Many of these infrastructure companies are structured as MLPs, tax-exempt publicly traded partnerships that operate cash-generating energy infrastructure assets, such as pipelines and storage tanks. They are designed to pass along most of their income to shareholders, making them appealing to investors seeking higher yields than they can currently get with bonds.

Several aspects of our investment approach to MLPs differentiates us from our peers. For one, in contrast to the typical energy portfolio, we have significant exposure to MLPs, which currently comprise close to 17% of net assets. Additionally, unlike many pure-play MLP funds and other investors that focus on high yield MLPs, we concentrate more on MLPs that are investing their cash in growth projects. We believe these MLPs not only have stronger growth potential, but also tend to have better business and financial risk profiles than their higher yield counterparts. We are also more selective than the pure-play MLP managers.

We have been investing in MLPs since the inception of the Fund, and have been fortunate to participate in the impressive growth trajectory of this class of stocks over the last few years. We still have positions in almost all of our early MLP investments, the majority of which have at least doubled in value, and continue to show solid growth prospects, including **Rose Rock Midstream, L.P.** and **Tesoro Logistics LP.** We continue to find what we believe are terrific opportunities in this group of stocks, such as **Valero Energy Partners LP**, which we invested in at the end of last year, and our newest MLP, **PBF Logistics LP.** We also invest in other types of companies that are benefiting from the infrastructure boom, such as **Targa Resources Corp.**, which is a general partner of an MLP, and shipping company **Scorpio Tankers Inc.**

## Alternative/Renewable Energy

Alternative energy, and in particular solar energy, is an area of growing interest to us, as declining costs have increasingly shrunk the economic gap between solar and conventional sources. In fact, solar energy is now at levels of grid parity in many regions across the globe, especially in emerging markets, where electricity and energy costs tend already to be high. We expect the cost of solar will continue to drop, and, as a result, the industry will not have to rely on government subsidies to the same extent as it has in the past. Innovation in financing is also lowering the cost of capital for some of these companies, which enhances their growth potential. The amount of energy from alternatives is still relatively small, but we believe that the growth rate over the next several years could be quite meaningful.

We made our first meaningful foray into investing in alternative energy earlier this year, initiating a position in **SunEdison, Inc.** Formerly known as MEMC Electronics, SunEdison is a semiconductor company that has transformed itself into a solar project developer with a global sales and installation capability. In July, the company spun off **TerraForm Power, Inc.**, as a YieldCo, an innovative financing structure that operates as the renewable energy equivalent of an MLP. Another YieldCo in which we are invested is **Abengoa Yield plc**, a subsidiary of Spanish energy company Abengoa S.A. We expect much of the growth of Abengoa Yield and other YieldCos to come from the acquisition of developed renewable electricity generation and transmission assets purchased from the parent company or third party developers of similar projects.

## Conclusion

With energy and resources stocks under-owned and, we believe, undervalued relative to the market, we think this is the opportune time for allocating capital into these sectors. The energy renaissance in the U.S. is still in its early stages, and we continue to find our best ideas in energy and energy-related stocks. We believe our Fund offers a differentiated investment in energy – one that is not closely tied to commodity pricing or its benchmarks, and instead focuses on the substantial pockets of growth opportunity in this sector. When we look at our estimates for production growth, improvements in per well productivity and recovery rates, increases in oilfield service intensity, escalating demand for infrastructure build-out, and increasing viability of alternative/renewable energy sources, we see a continuing opportunity for value creation and believe that the energy stocks we have researched and invested in will continue to be strong performers. ■

Baron Events

## Baron Investment Conference

Our 23nd Annual Baron Investment Conference will be held Friday, November 7, in New York City at the Metropolitan Opera House, Lincoln Center. Advance registration is required. For your free registration, visit www.BaronFunds.com/register, or call 1-800-99BARON, option 1. Our conference features guest speakers from the companies in which we invest and our own portfolio managers. Seating is limited. Preferred seating is available to those who qualify.

*Please read our registration requirements before registering.*

## Performance as of September 30, 2014

| RETAIL SHARES | Average Annualized Returns 1-Year | 5-Year | 10-Year | Since Inception Annualized | Cumulative | Inception Date | Expense Ratio | Ticker |
|---|---|---|---|---|---|---|---|---|
| **Baron Growth Fund** | 5.11% | 15.83% | 9.20% | 13.49% | 1116.88% | 12/31/94 | 1.30%[1] | BGRFX |
| **Baron Small Cap Fund** | 6.52% | 15.44% | 9.47% | 9.93% | 400.26% | 9/30/97 | 1.31%[1] | BSCFX |
| **Baron Discovery Fund** | 16.80% | N/A | N/A | 16.80% | 16.80% | 9/30/13 | 3.25%/1.35%[2] | BDFFX |
| **Baron Focused Growth Fund**[3] | 4.44% | 12.77% | 10.35% | 11.40% | 623.92% | 5/31/96 | 1.42%/1.35%[4] | BFGFX |
| **Baron Asset Fund** | 13.57% | 15.45% | 9.58% | 11.42% | 1816.00% | 6/12/87 | 1.32%[1] | BARAX |
| **Baron Opportunity Fund** | 2.87% | 13.67% | 10.26% | 4.94% | 102.07% | 2/29/00 | 1.37%[1] | BIOPX |
| **Baron Fifth Avenue Growth Fund** | 16.71% | 14.43% | 7.54% | 7.11% | 104.58% | 4/30/04 | 1.47%/1.30%[1] | BFTHX |
| **Baron Partners Fund**[3] | 15.27% | 18.56% | 10.84% | 13.11% | 1530.55% | 1/31/92 | 1.38%/0.29%[4] | BPTRX |
| **Baron Emerging Markets Fund** | 8.17% | N/A | N/A | 5.11% | 20.56% | 12/31/10 | 1.90%/1.50%[4] | BEXFX |
| **Baron Global Advantage Fund** | 17.29% | N/A | N/A | 15.11% | 40.51% | 4/30/12 | 5.51%/1.50%[4] | BGAFX |
| **Baron International Growth Fund** | 1.25% | 9.46% | N/A | 13.90% | 111.39% | 12/31/08 | 1.74%/1.50%[4] | BIGFX |
| **Baron Energy and Resources Fund** | 15.59% | N/A | N/A | 10.21% | 30.67% | 12/30/11 | 2.25%/1.35%[4] | BENFX |
| **Baron Real Estate Fund** | 16.84% | N/A | N/A | 20.90% | 146.30% | 12/31/09 | 1.35%[4] | BREFX |

| INSTITUTIONAL SHARES | Average Annualized Returns 1-Year | 5-Year | 10-Year | Since Inception Annualized | Cumulative | Inception Date | Expense Ratio | Ticker |
|---|---|---|---|---|---|---|---|---|
| **Baron Growth Fund** | 5.39% | 16.13% | 9.35% | 13.57% | 1133.83% | 12/31/94 | 1.05%[1] | BGRIX |
| **Baron Small Cap Fund** | 6.79% | 15.74% | 9.62% | 10.02% | 406.96% | 9/30/97 | 1.05%[1] | BSFIX |
| **Baron Discovery Fund** | 17.10% | N/A | N/A | 17.10% | 17.10% | 9/30/13 | 3.00%/1.10%[2] | BDFIX |
| **Baron Focused Growth Fund**[3] | 4.71% | 13.06% | 10.49% | 11.48% | 633.18% | 5/31/96 | 1.12%/1.10%[2] | BFGIX |
| **Baron Asset Fund** | 13.88% | 15.76% | 9.73% | 11.48% | 1843.29% | 6/12/87 | 1.05%[1] | BARIX |
| **Baron Opportunity Fund** | 3.10% | 13.97% | 10.42% | 5.04% | 104.92% | 2/29/00 | 1.11%[1] | BIOIX |
| **Baron Fifth Avenue Growth Fund** | 17.00% | 14.71% | 7.68% | 7.25% | 107.29% | 4/30/04 | 1.18%/1.05%[1] | BFTIX |
| **Baron Partners Fund**[3] | 15.58% | 18.87% | 11.00% | 13.18% | 1553.92% | 1/31/92 | 1.11%/0.30%[4] | BPTIX |
| **Baron Emerging Markets Fund** | 8.53% | N/A | N/A | 5.38% | 21.71% | 12/31/10 | 1.80%/1.25%[4] | BEXIX |
| **Baron Global Advantage Fund** | 17.56% | N/A | N/A | 15.38% | 41.31% | 4/30/12 | 4.91%/1.25%[4] | BGAIX |
| **Baron International Growth Fund** | 1.55% | 9.76% | N/A | 14.18% | 114.39% | 12/31/08 | 1.37%/1.25%[4] | BINIX |
| **Baron Energy and Resources Fund** | 15.96% | N/A | N/A | 10.47% | 31.50% | 12/30/11 | 2.84%/1.10%[4] | BENIX |
| **Baron Real Estate Fund** | 17.16% | N/A | N/A | 21.19% | 149.18% | 12/31/09 | 1.09%[4] | BREIX |

**Baron Growth, Baron Small Cap** and **Baron Discovery Funds** invest primarily in small-cap securities, **Baron Asset Fund** in mid-cap securities, **Baron Focused Growth** and **Baron International Growth Funds** in both. Small and mid-cap securities may be thinly traded and more difficult to sell during market downturns. **Baron Opportunity Fund** emphasizes mid-sized companies that we believe will benefit from innovations and advances in technology, which present the risk of rapid change and product obsolescence and their successes may be difficult to predict for the long term. **Baron Partners, Baron Focused Growth, Baron Real Estate** and **Baron Energy and Resources Funds** are non-diversified and **Baron Partners Fund** uses leverage, which increase volatility of the Funds' returns and expose the Funds to greater loss in any given period. In addition, the value of **Baron Real Estate Fund** is affected by the strength of the real estate markets. **Baron Fifth Avenue Growth Fund** invests primarily in large-cap securities, which like all equities are subject to price fluctuations in the stock market. **Baron International Growth, Baron Emerging Markets** and **Baron Global Advantage Funds** invests primarily in non-U.S. securities, which involve additional risks to those inherent in U.S. investments, including exchange-rate fluctuations, political or economic instability, the imposition of exchange controls, expropriation, limited disclosure and illiquid markets. These risks are heightened for the **Baron Emerging Markets Fund**. **Baron Energy and Resources Fund** invests in energy companies, which can be affected by fluctuations in energy prices and supply and demand of energy fuels, and in resources industries, which can be affected by international political and economic developments, the success of exploration projects, and meteorological events.

[1] As of September 30, 2013 for Baron Asset, Baron Growth, Baron Small Cap, Baron Opportunity and Baron Fifth Avenue Growth Funds. For Baron Fifth Avenue Growth Fund, the total expense ratio was 1.47% for the Retail share class and 1.18% for the Institutional share class, but the net annual expense ratio is 1.30% for the Retail share class and 1.05% for the Institutional share class (net of the Adviser's fee waivers).

[2] For Baron Discovery Fund, the estimated total expense ratio is 3.25% for the Retail share class and 3.00% for the Institutional share class, but the estimated net annual expense ratio is 1.35% for the Retail share class and 1.10% for the Institutional share class (net of the Adviser's fee waivers).

[3] Reflects the actual fees and expenses that were charged when the Funds were partnerships. The predecessor partnerships charged a 20% performance fee (Baron Partners Fund) or a 15% performance fee (Baron Focused Growth Fund) after reaching a certain performance benchmark. If the annual returns for the Funds did not reflect the performance fee for the years the predecessor partnerships charged a performance fee, returns would be higher. The Funds' shareholders are not charged a performance fee. The predecessor partnerships' performance is only for periods before the Funds' registration statements were effective (4/30/03 for BPF and 6/30/08 for BFGF). During those periods, the predecessor partnerships were not registered under the Investment Company Act of 1940 and were not subject to its requirements or the requirements of the Internal Revenue Code relating to registered investment companies, which, if they were, might have adversely affected their performance.

[4] As of December 31, 2013 for Baron Partners, Baron Focused Growth, Baron International Growth, Baron Real Estate, Baron Emerging Markets, Baron Energy and Resources and Baron Global Advantage Funds. Total expense ratio shown for Baron Partners Fund was comprised of operating expenses of 1.38% and interest expense of 0.29% for the Retail share class and 1.11% and 0.30%, respectively, for the Institutional share class. For Baron Focused Growth Fund, the total expense ratio was 1.42%, but the net annual expense ratio was 1.35% for the Retail share class and 1.12% and 1.10%, respectively, for the Institutional share class (net of the Adviser's fee waivers). For Baron International Growth Fund, the total expense ratio was 1.74%, but the net annual expense ratio was 1.50% for the Retail share class and 1.37% and 1.25%, respectively, for the Institutional share class (net of the Adviser's fee waivers). For Baron Emerging Markets Fund, the total expense ratio was 1.90%, but the net annual expense ratio was 1.50% for the Retail share class and 1.80% and 1.25%, respectively, for the Institutional share class (net of the Adviser's fee waivers). For Baron Energy and Resources Fund, the total expense ratio was 2.25%, but the net annual expense ratio was 1.35% for the Retail share class and 2.84% and 1.10%, respectively, for the Institutional share class (net of the Adviser's fee waivers). For Baron Global Advantage Fund, the total expense was 5.51%, but the net annual expense ratio was 1.50% for the Retail share class and 4.91% and 1.25%, respectively, for the Institutional share class (net of the Adviser's fee waivers).

Portfolio holdings as a percentage of net assets as of September 30, 2014 for securities mentioned are as follows: **Halliburton Co. -** Baron Energy and Resources Fund (3.7%); **Lekoil, Ltd. -** Baron Emerging Markets Fund (0.5%), Baron Energy and Resources Fund (0.8%); **Bonanza Creek Energy, Inc. -** Baron Small Cap Fund (0.7%), Baron Energy and Resources Fund (3.9%); **Concho Resources, Inc. -** Baron Asset Fund (1.3%), Baron Partners Fund (4.5%*), Baron Opportunity Fund (2.0%*), Baron Fifth Avenue Growth Fund (2.2%), Baron Energy and Resources Fund (3.8%); **Parsley Energy, Inc. -** Baron Energy and Resources Fund (2.9%), Baron Discovery Fund (0.6%); **RSP Permian, Inc. -** Baron Growth Fund (0.4%), Baron Energy and Resources Fund (2.3%), Baron Discovery Fund (0.5%); **Flotek Industries, Inc. -** Baron Small Cap Fund (0.8%), Baron Opportunity Fund (1.3%*), Baron Energy and Resources Fund (3.1%), Baron Discovery Fund (4.0%); **Forum Energy Technologies, Inc. -** Baron Small Cap Fund (0.9%), Baron Energy and Resources Fund (2.4%); **Rose Rock Midstream, L.P. -** Baron Energy and Resources Fund (3.3%), Baron Discovery Fund (2.3%); **Tesoro Logistics LP -** Baron Small Cap Fund (0.3%), Baron Energy and Resources Fund (1.1%); **Valero Energy Partners LP -** Baron Small Cap Fund (0.6%), Baron Energy and Resources Fund (1.0%); **PBF Logistics LP -** Baron Small Cap Fund (0.4%), Baron Energy and Resources Fund (1.7%), Baron Global Advantage Fund (1.7%), Baron Discovery Fund (1.9%); **Targa Resources Corp. -** Baron Growth Fund (2.1%), Baron Small Cap Fund (1.9%), Baron Energy and Resources Fund (1.7%); **Scorpio Tankers Inc. -** Baron Small Cap Fund (0.8%), Baron Energy and Resources Fund (1.3%); **SunEdison, Inc. -** Baron Energy and Resources Fund (1.7%); **TerraForm Power, Inc. -** Baron Asset Fund (0.5%), Baron Energy and Resources Fund (1.0%), Baron Global Advantage Fund (0.8%); **Abengoa Yield plc -** Baron Small Cap Fund (0.2%), Baron Energy and Resources Fund (0.5%).

* % of Long Positions.

*Performance for the Institutional Shares prior to 5/29/2009 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 5/29/2009 did not reflect this fee, the returns would be higher.*

If the Funds' historical performance was impacted by gains from IPOs and/or secondary offerings, there is no guarantee that these results can be repeated or that the Funds' level of participation in IPOs and secondary offerings will be the same in the future.

The Funds may not achieve their objectives. Portfolio holdings may change over time.

The Adviser has reimbursed certain Fund expenses for Baron Opportunity Fund, Baron Fifth Avenue Growth Fund, Baron Focused Growth Fund, Baron International Growth Fund, Baron Real Estate Fund, Baron Emerging Markets Fund, Baron Energy and Resources Fund, Baron Global Advantage Fund and Baron Discovery Fund (by contract as long as BAMCO, Inc. is the adviser to the Funds).

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