BARON INSIGHT
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Investing in Financials

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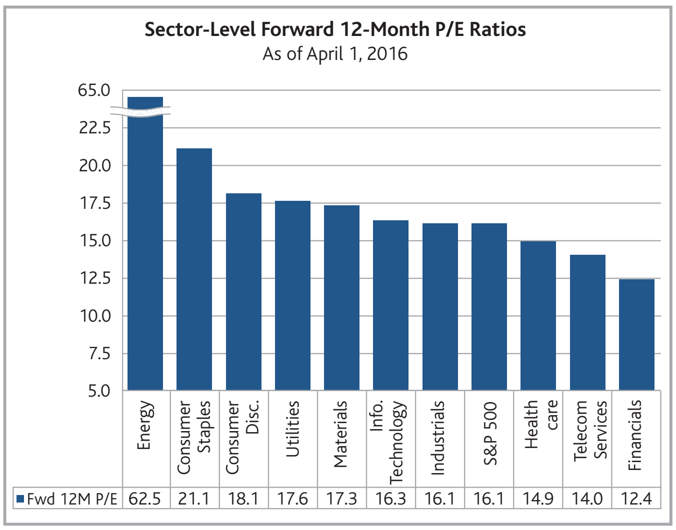
The Financials sector has lagged significantly since the 2007-08 financial crisis. As of March 31, 2016, the category was down 14% since its October 9, 2007 peak, compared with the broader market as measured by the Russell 3000 Index, which increased 59%. Many financial companies experienced subdued profitability and growth in the aftermath of the crisis as a result of heightened regulation, fines, and historically low interest rates. Most recently, credit risk in the energy space has weighed on the sector. The decreasing likelihood of near-term U.S. Federal Reserve rate hikes has not helped either.

While their stock prices lag, financial company fundamentals and the economy continue to improve. Most financial institutions have paid back government loans and some are increasing share buybacks and dividend payments, reflecting greater financial soundness and stability. Balance sheets of consumers and companies are in significantly better shape than in 2008. Corporate cash balances are high, and household debt service as a percentage of disposable income has fallen. Reduced consumer debt loads lower the risk of defaults and provides room to add to debt if desired. While holding to the status quo for the moment, the Fed still appears to want to move rates to a more "normal" level, although timing of future rate hikes is uncertain.

We think now is the perfect time to take a closer look at the Financials sector. While valuations for the broader market are at or slightly above their long-term average, financial stocks continue to trade at a discount to long-term average valuations. As seen in the chart below, Financials is the least expensive sector in terms of price to earnings ratio.



Source: FactSet

Baron has a long and successful history of utilizing its bottom-up, research-driven, long-term investment approach in the Financials sector. As with all of our investments, Baron looks for financial companies that have significant long-term growth opportunities, sustainable competitive advantages, and strong management teams, at an attractive valuation. We believe this investment style and the sector's relative value have allowed us to discover many potentially successful investments in Financials.

Opportunities in Banks and Insurance

Although traditional banks and insurance companies comprise a large weight in the Financials index, Baron tends not to invest in these businesses because they don't typically meet our investment criteria. Banks and insurers are generally commoditized, cyclical, asset-intensive businesses with limited growth potential. We have also found that the fair values of their assets and liabilities may deviate significantly from what's shown on their balance sheets due to inherently subjective estimates of future losses.

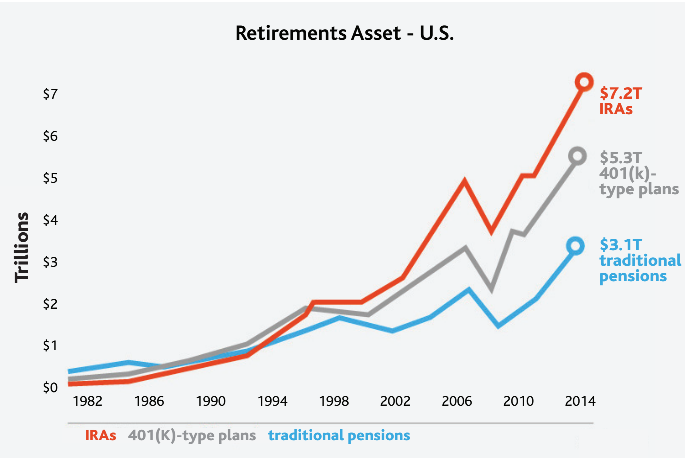
However, some banks and insurers are able to flourish through differentiation, management expertise, and smart strategic execution. To discover these firms, we look for strong management teams who have proven to be good stewards of capital and seek out growth opportunities in a prudent and conservative fashion.

We own **Arch Capital Group Ltd.**, a specialty insurance and reinsurance company run by an experienced management team with a successful track record across several insurance cycles. Arch excels at underwriting specialized property & casualty policies and can shift its business mix to target the most profitable areas. The company has a unique compensation system for its underwriters that rewards long-term profitability rather than short-term premium growth. Management has demonstrated excellent underwriting discipline and has returned excess capital to shareholders during soft pricing cycles, allowing Arch to maintain industry-leading returns on equity. Its stock has doubled in the last five years.

We're also invested in **First Republic Bank**, which provides banking and wealth management services to affluent customers in urban, coastal markets across the U.S. First Republic was founded 30 years ago, acquired in 2007 by Merrill Lynch (which subsequently merged with Bank of America), and spun off as a separate company again in 2010. First Republic differentiates itself through its singular focus on providing exceptional customer service, resulting in high customer loyalty and superior growth. The bank is well-capitalized and is led by an experienced management team that has demonstrated superior underwriting performance over many years. First Republic's stock has risen over 160% since its IPO in 2010 as its high-touch business model and affluent customer base have driven strong market share gains.

Servicing Individual Investors

As the chart below demonstrates, over the past 30 years, most employers have shifted from defined benefit pensions to 401(k)s, and industry observers expect this migration to continue. We believe this shift in retirement saving and investing responsibility from the employer to the employee has created opportunities for companies providing individual investors with advice on managing their retirement accounts.



Source: dol.gov

Several of the companies we own service the growing need for investment advice among individual investors. **Financial Engines, Inc.** is an advisory service for employees of participating employer retirement plans. While it is the significant market leader, it still has just $115 billion in 401(k) assets under management in a highly fragmented market. Its relationships with plan record keepers provide access to over $3 trillion in assets and its products are applicable to the vast majority of these accounts. We think Financial Engines has a long runway of growth as more plan sponsors provide their employees with access to its products, individual investors utilize its services, and new channels of distribution are opened beyond the retirement space.

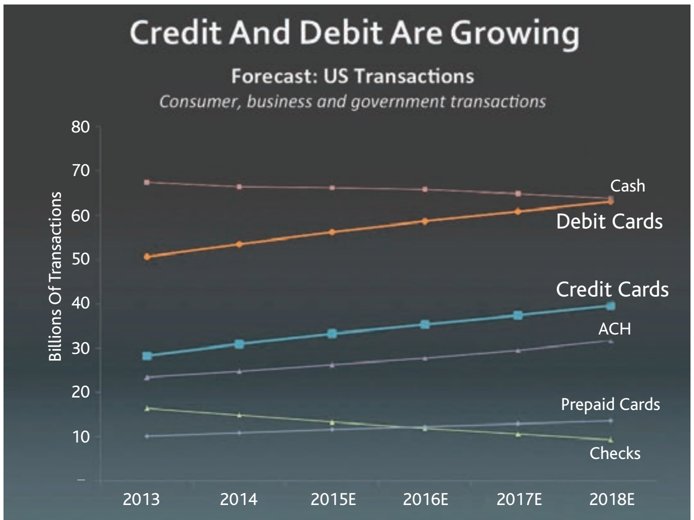
We are also investors in **The Charles Schwab Corp.**, a premier discount brokerage firm offering securities brokerage and other financial services to individual investors and independent financial advisors. We have owned this company since 1992, when the stock was trading at a split adjusted price of around $1 per share. Today, it trades at more than 30 times that amount. Despite this impressive growth, we feel the company still has many opportunities ahead. Management's emphasis on earning customer trust has made it, in our view, a sterling brand. We believe its premium brand and superior services will allow Schwab to continue winning share in its core business. Additionally, the Investor Services division has broadened its offerings to include investment management and advice. Its recently released product, Schwab Intelligent Portfolio, manages a client's assets for no additional cost by utilizing proprietary product and the Schwab bank. We believe this complimentary service will be difficult for rivals to match and will create sticky and valuable customer relationships.

Primerica, Inc. also serves a growing need for financial planning in an underserved customer segment. The company provides term life insurance and third-party investment products to middle income households that are often ignored by other financial companies. Primerica has a multi-level sales model that positions the company to reach middle income investors in a cost-efficient manner and help them set and achieve their financial goals.

We have also invested in select asset managers that are providing a differentiated product, have competitively advantaged distribution channels, and have a strong brand that we believe can weather turbulent markets. **The Carlyle Group** and **Oaktree Capital Group, LLC** participate in the faster growing alternative management sector, and both firms continue to win market share due to their track records and excellent customer service. **Artisan Partners Asset Management Inc.** has assembled a lineup of top traditional managers who can provide various investment products under a single umbrella.

Trends in Financial Technology

Powerful secular trends are driving growth in financial technology. A shift from cash to electronic payments, the increasing use of data and analytics, the electronification of capital markets – these trends and others are opening the door to what we think are attractive opportunities for investors with an in-depth understanding of the shifting technological and regulatory landscapes.



Source: Federal Reserve, BI Intelligence

As the chart on the previous page demonstrates, payments are increasingly shifting from cash and checks to cards and digital payments. We're invested in **Visa, Inc.** and **MasterCard, Inc.**, two of the world's largest payment networks. Both companies have dominant positions in the U.S., as well as significant exposure to international markets, where consumer spending and the adoption rate of electronic payments are rising quickly. These technology-based businesses don't take credit risk but instead partner with issuing banks and function like toll collectors for global consumption spending. We believe Visa and MasterCard enjoy high barriers to entry given their well-established brands, large merchant acceptance networks, and extensive banking relationships.

Further down the payments value chain sit merchant acquirers and processors, who act as the "sales and distribution" arm of the payments industry. Acquirers enable merchants to accept credit and debit card payments by connecting them to the various networks. **Vantiv, Inc.** is a leading merchant acquirer and payment processor in the U.S. that directly benefits from growth in consumer spending and the secular shift from cash to electronic payments. The company is gaining share due to investments in integrated payments technology and e-commerce capabilities. A significant industry shift toward chip-based, EMV cards should drive continued strong organic growth, in our view. London-based **Worldpay Group plc** is the largest merchant acquirer in Europe, serving a diverse set of 400,000 merchants across 146 countries in 126 currencies. The company is the dominant player in the attractive U.K. payments market and has a fast growing and highly profitable e-commerce business that's benefiting from the rapid growth of online commerce.

Businesses are increasingly using technology and data to improve efficiency. **FleetCor Technologies, Inc.** and **WEX Inc.** provide fuel cards and other payment services to vehicle fleets and businesses around the world. These services enable corporate customers to better manage and control employee spending and reduce the administrative burden of commercial payments. Fuel cards and electronic payments have long runways for growth in large addressable markets. FleetCor and WEX are leaders in this fast-growing and rapidly consolidating industry niche. Both companies enjoy high barriers to entry due to their advanced technology, economies of scale, and broad merchant acceptance networks.

Technology is also transforming the capital markets. Trading across asset classes continues to migrate away from trading pits and phones to electronic venues. Regulatory changes enacted after the global financial crisis have accelerated this shift as higher capital and liquidity requirements for banks have restricted their ability to act as effective market-makers. **MarketAxess Holdings Inc.** operates the dominant electronic platform for trading corporate bonds. We believe the corporate bond market is in the early innings of a secular shift from voice-based trading to electronic trading, and that MarketAxess will be the prime beneficiary of this transition. Other portfolio companies that benefit from the growth of electronic trading include **Virtu Financial, Inc.**, a leading electronic market-maker, and **CME Group, Inc.**, operator of the world's largest and most diversified financial exchanges for trading derivatives. We think all of these companies will benefit from growth in trading volumes during periods of higher market volatility as well as an eventual normalization of interest rates.

Opportunities Abroad

We invest in Financials companies located overseas through our three international funds. In addition to our traditional investment criteria, we look for companies that are poised to benefit from secular or structural growth opportunities in their regional markets. For instance, we own **Credicorp Ltd.**, the largest financial services company in Peru, with dominant positions in banking, insurance, and asset management. In addition to a high quality management team and a track record of delivering solid profitability, we think Credicorp stands to benefit from two major secular trends: an increase in banking penetration and favorable demographics. Peru is still vastly underserved in terms of financial services, with a loan/GDP ratio of roughly 27%, among the lowest in Latin America, implying significant room for banks to increase lending. In addition, a population with a young, but increasing, median age; a reduction in poverty levels; and a gradual formalization of the labor force will boost demand for financial services, in our view.

China Everbright Ltd., an asset management firm that has grown assets under management (AUM) at a 30% CAGR over the last five years, is another example. According to market research firm Oliver Wyman, as of 2013, just 3% of China's RMB 145 trillion in investable assets was held in mutual funds. As investment constraints for institutional/state-owned investors are relaxed, Chinese households shift from saving to investing, and China pushes to internationalize the RMB, AUM in China are expected to grow from RMB 4 trillion in 2013 to RMB 24 trillion in 2020. In addition, we believe low interest rates driven by the government's economic stimulus will compel more households to move assets out of traditional, low-yielding products such as savings accounts into professionally managed products. Taken together, we believe these trends represent a massive opportunity for fund managers such as China Everbright.

Conclusion

With low valuations, improving economic conditions, and the possibility of more normalized interest rates on the horizon, we believe now is an excellent time to utilize our distinct approach to finding and investing in financial companies poised to grow and thrive.

Performance data quoted represents past performance. Past performance is no guarantee of future results. Current performance may be lower or higher than the performance data quoted herein.

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

The discussion of market trends and companies throughout this report are not intended as advice to any person regarding the advisability of investing in any particular security. Some of our comments are based on current management expectations and are considered "forward-looking statements." Actual future results, however, may prove to be different from our expectations. Our views are a reflection of our best judgment at the time of the publication of this report and are subject to change any time based on market and other conditions, and we have no obligation to update them. Investing in the stock market is always risky. Baron may not achieve its objective.

Portfolio holdings as a percentage of net assets as of March 31, 2016 for securities mentioned are as follows: **Arch Capital Group Ltd.** – Baron Asset Fund (3.6%), Baron Growth Fund (4.6%), Baron Partners Fund (8.0%*), Baron Focused Growth Fund (4.0%), Baron International Growth Fund (2.3%); **First Republic Bank** – Baron Asset Fund (1.3%); **Financial Engines, Inc.** – Baron Growth Fund (1.2%), Baron Small Cap Fund (1.2%), Baron Focused Growth Fund (3.5%); **The Charles Schwab Corp.** – Baron Asset Fund (2.9%), Baron Opportunity Fund (2.4%*), Baron Partners Fund (4.0%*), Baron Fifth Avenue Growth Fund (1.6%); **Primerica, Inc.** – Baron Growth Fund (2.0%); **The Carlyle Group** – Baron Growth Fund (0.4%), Baron Partners Fund (2.2%*), Baron Focused Growth Fund (2.5%); **Oaktree Capital Group, LLC** – Baron Growth Fund (1.2%); **Artisan Partners Asset Management Inc.** – Baron Growth Fund (0.2%), Baron Small Cap Fund (0.3%); **Visa, Inc.** – Baron Opportunity Fund (1.6%*), Baron Fifth Avenue Growth Fund (4.1%); **MasterCard, Inc.** – Baron Opportunity Fund (1.6%*), Baron Fifth Avenue Growth Fund (4.0%); **Vantiv, Inc.** – Baron Asset Fund (1.0%); **Worldpay Group plc** – Baron International Growth Fund (1.6%), Baron Global Advantage Fund (3.2%*); **FleetCor Technologies, Inc.** – Baron Asset Fund (3.0%), Baron Small Cap Fund (2.3%); **WEX Inc.** – Baron Small Cap Fund (1.4%); **MarketAxess Holdings Inc.** – Baron Asset Fund (1.0%), Baron Opportunity Fund (1.8%*); **Virtu Financial, Inc.** – Baron Growth Fund (0.5%), Baron Focused Growth Fund (1.2%); **CME Group, Inc.** – Baron Fifth Avenue Growth Fund (2.2%); **Credicorp Ltd.** – Baron Emerging Markets Fund (0.4%); **China Everbright Ltd.** – Baron Emerging Markets Fund (0.8%).

Portfolio holdings may change over time.

*% of Long Positions

PRODUCTS WE OFFER

We offer thirteen mutual funds in retail, institutional, and R6 share classes, collective investment trusts, separately managed accounts, sub-advisory services and an offshore fund.

STRATEGIES

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BARON DISCOVERY STRATEGY
BARON EMERGING MARKETS STRATEGY
BARON ENERGY & RESOURCES STRATEGY
BARON FOCUSED GROWTH STRATEGY
BARON FOCUSED HIGH GROWTH STRATEGY
BARON GLOBAL ADVANTAGE STRATEGY
BARON HIGH GROWTH STRATEGY
BARON INTERNATIONAL GROWTH STRATEGY
BARON LARGE CAP GROWTH STRATEGY
BARON MID CAP GROWTH STRATEGY
BARON REAL ESTATE STRATEGY
BARON SMALL CAP GROWTH STRATEGY
BARON SMALL TO MID-CAP GROWTH STRATEGY

MUTUAL FUNDS

BARON ASSET FUND (BARAX, BARIX, BARUX)
BARON DISCOVERY FUND (BDFFX, BDFIX)
BARON EMERGING MARKETS FUND (BEXFX, BEXIX, BEXUS)
BARON ENERGY AND RESOURCES FUND (BENFX, BENIX)
BARON FIFTH AVENUE GROWTH FUND (BFTHX, BFTIX, BFTUX)
BARON FOCUSED GROWTH FUND (BFGFX, BFGIX)
BARON GLOBAL ADVANTAGE FUND (BGAFX, BGAIX)
BARON GROWTH FUND (BGRFX, BGRIX, BGRUX)
BARON INTERNATIONAL GROWTH FUND (BIGFX, BINIX)
BARON OPPORTUNITY FUND (BIOPX, BIOIX)
BARON PARTNERS FUND (BPTRX, BPTIX)
BARON REAL ESTATE FUND (BREFX, BREIX, BREUX)
BARON SMALL CAP FUND (BSCFX, BSFIX, BSCUX)

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