December 31, 2020

Baron Real Estate Fund

Dear Baron Real Estate Fund Shareholder:

The Baron Real Estate Fund (the "Fund") generated exceptionally strong performance in 2020, gaining 44.28% (Institutional Shares) for the year ended December 31, 2020.

The Fund's 44.28% gain in 2020 substantially outperformed both its primary benchmark index, the MSCI USA IMI Extended Real Estate Index (the "MSCI Real Estate Index"), that rose only 4.21%, and the MSCI US REIT Index, that declined by 8.70%.

For the most recent three-month period ended December 31, 2020, the Baron Real Estate Fund increased 16.79%, exceeding the returns of 10.35% by the MSCI Real Estate Index and 11.16% by the MSCI US REIT Index.

Baron Real Estate Fund Cumulative Return Since Inception *(December 31, 2009 through December 31, 2020)*

- **Baron Real Estate Fund: 446.66%**
- MSCI Real Estate Index: 239.73%
- MSCI U.S. REIT Index: 149.50%

The Fund has received special recognition from **Morningstar** for its achievements:

Morningstar Real Estate Category Ratings *(as of December 31, 2020)*

- **Morningstar Overall Rating™:**
  - Baron Real Estate Fund received a 5-star Morningstar Overall Morningstar Rating™
- **Morningstar 10-Year, 5-Year, 3-Year Ratings:**
  - Baron Real Estate Fund received a 5-star Morningstar Rating™ for each of its full 10-year, 5-year, and 3-year performances

Morningstar Real Estate Category Rankings *(as of December 31, 2020)*

- **Morningstar 10-Year, 3-Year, and 1-Year Ranking:**
  - Baron Real Estate Fund ranked as the #1 real estate fund for each of its 10-year, 3-year, and 1-year performances

JEFFREY KOLITCH
PORTFOLIO MANAGER

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

- **Morningstar 5-Year Ranking**:
  - Baron Real Estate Fund ranked in the top 2% of all real estate funds

We will address the following topics in this letter:

- A chronicle of our key action steps managing the Fund in 2020
- The investment case for active management of public real estate and the Fund
- The prospects for real estate in the public markets (*preview:* we remain bullish!)
- Our 2021 investment themes and portfolio composition
- Our concluding thoughts and observations

As of 12/31/2020, the Morningstar Ratings™ were based on 225, 199, 144, and 225 share classes for the 3-year, 5-year, 10-year, and Overall periods, respectively. The Morningstar Ratings are for the Institutional Share Class only; other classes may have different performance characteristics.

As of 12/31/2020, the Morningstar Real Estate Category consisted of 248, 225, 199, and 144 share classes for the 1-, 3-, 5-, and 10-year periods. Morningstar ranked Baron Real Estate Fund Institutional Share Class in the 1st, 1st, 2nd, and 1st percentiles, respectively. On an absolute basis, Morningstar ranked Baron Real Estate Fund Institutional Share Class as the 1st, 2nd, 4th, and 1st best performing share class in its Category, for the 1-, 3-, 5-, and 10-year periods, respectively.

As of 12/31/2020, the Morningstar Real Estate Category consisted of 248 and 225 share classes for the 1- and 3-year periods. Morningstar ranked Baron Real Estate Fund R6 Share Class in the 1st and 1st percentiles, respectively. On an absolute basis, Morningstar ranked Baron Real Estate Fund R6 Share Class as the 1st and 1st best performing share class in its Category for the 1- and 3-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 performance figures 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

Table I.
Performance
Annualized for periods ended December 31, 2020

	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]	16.70%	16.79%	10.35%	11.16%
One Year	43.85%	44.28%	4.21%	(8.70)%
Three Years	17.26%	17.56%	6.60%	2.25%
Five Years	15.67%	15.97%	9.13%	3.51%
Ten Years	15.43%	15.72%	10.53%	6.99%
Since Inception (December 31, 2009) (Annualized)	16.40%	16.70%	11.76%	8.67%
Since Inception (December 31, 2009) (Cumulative)[3]	431.65%	446.66%	239.73%	149.50%

A CHRONICLE OF OUR KEY ACTION STEPS MANAGING THE FUND IN 2020

2020 was a notably active year managing the Fund due to the acceleration and emergence of headwinds and tailwinds in certain segments of real estate, the unprecedented economic and social lockdown, and the resulting stock market volatility.

Our decision to implement a more active and aggressive portfolio management playbook (we initially played defense, then we played offense) than our more typical Baron lower turnover approach produced strong performance results in an extremely challenging and unpredictable year for numerous categories of public real estate.

In 2020, the Fund's 44.28% gain, measured against the 8.70% decline of the MSCI US REIT Index, was the Fund's best annual comparative performance since its inception eleven years ago. The Fund also generated its best annual performance versus its primary benchmark, the MSCI Real Estate Index.

Our key action steps (the heavy lifting)–buying and selling securities, raising cash, deploying cash, repositioning the portfolio, and prioritizing certain investment themes–occurred earlier in 2020 (February, March, and early April).

Key portfolio repositioning in the early portion of 2020 included the following:

- Sold a significant portion of the Fund's travel-related holdings at favorable prices and raised cash for redeployment.

  Upon the emergence of the COVID-19 virus, it became apparent that this outbreak might develop into a global pandemic. We quickly recognized that the Fund's investments in travel-related real estate categories, which had accounted for about 25% of the portfolio, should be reduced, given the prospects of a significant curtailing of worldwide travel.

  We proactively decreased our investments in travel-related holdings (hotel, casinos & gaming, cruise line, and timeshare companies) at favorable prices early in the first quarter and raised cash, representing approximately 15% to 19% of the Fund's net assets and the only instance of the Fund's large cash position since its inception 11 years ago.

  By mid-March, following the sharp correction in numerous share prices, we reinvested the bulk of the proceeds at much more favorable prices.

  Following the reinvestments, cash represented only 4.2% of net assets at the end of the first quarter. We maintained a low cash position for the balance of the year.

- Purchased best-in-class companies that were "on sale."

  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 whose interests are aligned with shareholders

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, 2019 was 1.33% and 1.08%, 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, 2031, 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. The indexes and the Fund include reinvestment of interest, capital gains and dividends, which positively impact the performance results. MSCI is the source and owner of the trademarks, service marks and copyrights related to the MSCI Indexes. MSCI is a trademark of Russell Investment Group. The indexes are unmanaged. The 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.

Examples of best-in-class real estate companies that we added to earlier in 2020 at highly attractive prices include:

- Housing-related: **Home Depot, Inc.**, **The Sherwin-Williams Company**, **D.R. Horton, Inc.**, and **Lennar Corporation**
- Commercial real estate services companies: **CBRE Group, Inc.**
- Real estate operating companies: **Brookfield Asset Management, Inc.**
- REITs: **Prologis, Inc.** and **American Tower Corp.**

Note that these statements represent the manager's opinion and is not based on a third-party ranking.

• The Fund prudently purchased cyclical stocks that had declined sharply in the downturn but possess the potential to appreciate significantly over the next few years.

Upon the resumption of normalized economic activity, we anticipate that the shares of many beaten down cyclical companies, such as travel and hospitality-related real estate companies and certain REITs, may lead the market higher.

• Increased the Fund's exposure to housing-related companies benefiting from structural tailwinds and the pandemic.

In contrast to our aggressive first quarter re-alignments, we made only minor adjustments to the portfolio in the second and third quarters of 2020. In the most recent fourth quarter, however, we were active, once again, purchasing and trimming stocks in preparation for the year ahead. More on this topic in the "Key Investment Themes and Portfolio Construction" section below.

Table II.
Top net purchases for the quarter ended December 31, 2020

	Quarter End Market Cap (billions)	Amount Purchased (millions)
Douglas Emmett, Inc.	$ 5.1	$19.2
Six Flags Entertainment Corporation	2.9	16.6
The Howard Hughes Corporation	4.3	15.7
Opendoor Technologies Inc.	12.4	15.0
American Assets Trust, Inc.	1.7	13.9

In the quarter ended December 31, 2020, we purchased shares in several attractively valued real estate companies that lagged in 2020 in large part due to temporary operational headwinds caused by COVID-19. Examples include the purchase of shares in certain REITs, such as **Douglas Emmett, Inc.** and **American Assets Trust, Inc.,** amusement park operators such as **Six Flags Entertainment Corporation**, and land developer **The Howard Hughes Corporation**. We expect the business prospects and share prices of several real estate laggards to recover in 2021 if COVID-19 vaccinations are widely administered and economic activity accelerates.

We also acquired shares in **Opendoor Technologies Inc.** Like Zillow Group, Inc., another Fund holding, Opendoor provides a digital platform for residential real estate that allows for the purchase and sale of homes on a mobile device. We are quite optimistic about the long-term growth prospects for Opendoor and Zillow and will have much more to say about these companies in future shareholder letters.

Table III.
Top net sales for the quarter ended December 31, 2020

	Quarter End Market Cap (billions)	Amount Sold (millions)
Zillow Group, Inc.	$30.6	$17.7
Penn National Gaming, Inc.	13.4	14.2
Lennar Corporation	23.3	11.7
Wynn Resorts Ltd.	12.2	11.4
Installed Building Products, Inc.	3.0	10.5

Following exceptionally strong share price performance in 2020, we modestly trimmed the Fund's positions in the companies highlighted above. We remain positive, however, about the long-term prospects for each of the companies.

THE INVESTMENT CASE FOR ACTIVE MANAGEMENT OF PUBLIC REAL ESTATE AND THE FUND

The investment case for active management of public real estate

We believe the case for investing in an actively managed public real estate mutual fund is compelling – more so than ever.

In 2020, cross currents developed in real estate – in large part due to the Coronavirus – some of which may persist in the years ahead.

Consequently, the public real estate universe has evolved into a narrower set of compelling investment opportunities.

Some segments of real estate are experiencing an acceleration in business fundamentals. These include residential homes for sale, single-family home rentals, manufactured housing, industrial warehouse and cold storage companies, data center and wireless tower companies, and life science real estate.

Certain segments of real estate are facing headwinds and an expected slowdown in long-term growth. The shift to e-commerce shopping continues to negatively impact retail malls and shopping centers, and this trend should fast-track the pace and number of retail store closings. Working from home, or anywhere, and the rise of video teleconferencing are likely to pressure occupancy and rents for office and urban apartment landlords and weigh on business travel.

A passive real estate strategy replicates a specific real estate benchmark or index. It owns the entire universe of public real estate companies – the companies benefiting from operating tailwinds and the companies facing multi-year operating headwinds.

An actively managed real estate strategy, such as the Baron Real Estate Fund, can be discerning by prioritizing companies with attractive long-term prospects while de-emphasizing companies with unappealing long-term prospects.

The investment case for Baron Real Estate Fund – an actively managed and differentiated real estate fund

We launched Baron Real Estate Fund eleven years ago on December 31, 2009. At that time, we noted that we expected the Fund's more flexible investment approach to be a key competitive advantage over the long term.

Baron Real Estate Fund

Our investment philosophy and strategy has been to structure and maintain a more expansive and actively managed real estate fund–one that contains REITs, but also invests in various non-REIT companies that operate within or provide services or products to the real estate industry.

In our opinion, the Fund's flexibility is a critical competitive advantage.

Baron Real Estate Fund, unlike passively managed real estate strategies and most REIT funds, has a greater ability to pick our spots and pivot away from the real estate categories that are likely to face long-term occupancy, rent, and cash flow pressures.

We tend to prioritize companies with:

- Unique competitive advantages that limit competition and enable outsized reinvestment returns
- Long runways for non-cyclical cash flow growth
- Relatively capital efficient business models

We de-emphasize companies with:

- Secular growth headwinds
- Oversupplied conditions
- Highly uncertain medium-term demand prospects

At times, we may acquire shares opportunistically in companies facing near- to medium-term headwinds if we determine that the return profile is attractive and risk profile is acceptable. However, opportunistic purchases of companies facing headwinds is not a portfolio management and risk management priority.

Our actively managed approach to investing in real estate has yielded strong results. Since the launch of the Fund eleven years ago on December 31, 2009, the Fund has increased 446.66% cumulatively (net of fees) which compares favorably to the performance of the largest real estate passive strategy, the Vanguard Real Estate ETF ("VNQ"), which increased 194.67%.

If we are correct regarding the evolving real estate landscape, the merits of Baron Real Estate Fund's broader and more flexible investment approach and actively managed methodology may become even more apparent in the years ahead.

THE PROSPECTS FOR REAL ESTATE IN THE PUBLIC MARKETS

In 2020, we were steadfast in our view that the prospects for real estate and Baron Real Estate Fund were compelling.

At the end of the first quarter, we cited that ***the dramatic correction in so many share prices presented a once-in-a-generation, perhaps a once-in-a-career, buying opportunity.***

At that time and throughout the balance of 2020, we stated that our optimism was due to the following considerations:

- The double barrel of unlimited monetary stimulus and massive fiscal stimulus would bolster the economy and stock market.
- Following the sharp correction in share prices, equity valuations were attractive. In fact, we believed that the flight from the market had produced some extraordinary and rare investment opportunities.
- Residential and commercial real estate would rebound as economic activity resumes.
- Additional reasons to be optimistic included historically low interest rates, inflation, and gasoline prices, and, in most cases, strong corporate balance sheets.
- The economic effects of the pandemic crisis would be largely mitigated.
- Medical experts anticipated modern medical advances and a vaccine that would be broadly available by the summer of 2021 or sooner.
- The start of a new economic cycle.
- Several segments of residential and commercial real estate had begun to rebound.
- The prospects for Baron Real Estate Fund were strong due to the quality of the Fund's holdings, the majority of which were "on sale" at exceptionally attractive prices.

Our current thoughts regarding the prospects for real estate and the Fund

At the outset of 2021, we remain optimistic about the prospects for real estate and the Fund. We do not, however, anticipate replicating the Fund's annual gains of 44.44% and 44.28% in 2019 and 2020, respectively.

We remain bullish due to four key considerations:

1. We believe the relative appeal of public real estate stocks is compelling.
2. The real estate cycle has reset and most real estate cycles last five to seven years.
3. We continue to identify attractively valued segments of the real estate sector.
4. We expect portions of real estate to be notable beneficiaries of widespread COVID-19 vaccinations.

1. The relative appeal of public real estate

In our opinion, *many public real estate companies remain attractively valued relative to equity, bond, and private real estate alternatives*.

Public real estate relative to other equity alternatives

In 2020, the S&P 500 Index increased 18.40%, the NASDAQ Composite Index increased 44.92%, and global equities (as defined by the MSCI ACWI Index) increased 16.25%.

Much of the real estate sector, however, lagged. In 2020, the MSCI US REIT Index declined 8.70% (with several REITs down 20% to 40%), many hospitality-related real estate companies (e.g., hotels, timeshare, and real estate casino gaming companies) down 10% to 20% and leading commercial real estate services companies declined 10% to 20%.

In 2020, certain real estate businesses–hotels and other hospitality-related companies, apartment, office, retail, and other commercial real estate-related companies–were challenged due to the highly unusual pandemic-induced economic downturn. In our opinion, the businesses of many of these companies are cyclically depressed, not secularly challenged, and will recover when economic conditions improve.

The valuation disparity between many real estate securities and non-real estate stocks remains, in our opinion, extreme. **The MSCI US REIT Index is currently priced at a discount to the S&P 500 Index for the first time since 2009!**

Public real estate relative to bonds

Following the plunge in bond yields to historic lows, bonds offer investors negligible yields.

In the U.S., for example, the 10-year Treasury yield has declined to only 0.9% versus a long-term average of 5.7%.

A June 30, 2020 *Wall Street Journal* article noted that two years ago 36% of bonds had yields less than 2%. The article went on to state that **about 85% of global bonds had yields less than 2%!**

On the other hand, the dividend yield on **REITs currently stands at approximately 3.5%**, and several other real estate securities offer compelling total return potential relative to bonds.

Public real estate relative to real estate in the private market

We believe there is a compelling arbitrage opportunity in the public real estate market relative to the private market.

With the correction in several real estate stocks in 2020, the valuations of recent private market real estate transactions suggest that **it is notably cheaper to buy certain segments of real estate in the public market than in the private market.**

Final thought on the relative appeal of real estate

We do not have a crystal ball to predict when the stock market will pivot to laggard areas such as certain segments of real estate.

We do, however, have high conviction that in the next 6 to 12 months – perhaps in response to further medical advances, wide-spread vaccinations for COVID-19, and a further reopening of the economy – a large segment of public real estate will rebound and the recovery in some of the share prices may be sharp.

And so, we believe now is a compelling time to invest in public real estate.

2. The real estate cycle has reset

Most real estate cycles tend to last five to seven years, then correct for one to two years, and then a new cycle begins.

Key factors that serve as tailwinds at the onset of a real estate cycle then become headwinds at later stages of a real estate cycle include interest rates, mortgage rates, central bank policy, inflation, economic growth, residential and commercial construction activity, corporate balance sheet liquidity and debt levels, and the credit markets.

Following the sharp decline in global economic activity in 2020, we believe the U.S. real estate cycle has reset and is in the early stages of what we anticipate will be a multi-year recovery.

In our opinion, several conditions are in place that should serve as tailwinds and contribute to an improvement in business performance for a large swath of commercial and residential real estate in the next few years. A sampling includes:

Historically low interest rates: The 10-Year U.S. Treasury yield currently stands at 0.9% versus its 50-year average of 6.2%!

Record low mortgage rates: The 30-year U.S. fixed mortgage rate of only 2.7% compares favorably to its long-term average rate of 7.9%!

Accommodative central bank policy: On September 16, 2020, the Fed signaled that it intends to keep interest rates near zero through at least 2023.

Subdued consumer price inflation ("CPI"): CPI is significantly below the Fed's 2% inflation target, and it may remain subdued due to technological and productivity advances.

Improving economic growth: Recent economic and company business results confirm that the U.S. economy bottomed in April. We believe a new economic expansion has begun and most economic cycles last five to seven years.

Modest levels of commercial construction activity: Supply growth remains low by historical standards.

An under-supply of inventory of residential homes: Residential inventory levels remain low.

Healthy corporate balance sheets: Corporate balance sheets are generally in solid shape with ample cash, appropriate debt levels, and staggered debt maturities.

The share prices and valuations of several public real estate companies remain depressed: Valuations are reasonable relative to interest rates and many other investment alternatives.

3. We continue to identify attractively valued segments of the real estate sector

We believe the valuations of several real estate companies–certain REITs, real estate services companies, homebuilders, casino and gaming companies, and many other commercial and residential-related real estate companies–remain "on sale." As such, we believe the prospective returns in the next few years for several real estate stocks and the Fund remain attractive.

4. We expect portions of real estate to be notable beneficiaries of widespread COVID-19 vaccinations

Several segments of real estate have been in the cross hairs of the pandemic.

Business results of hotels, office buildings, urban apartment buildings, retail malls and shopping centers, senior housing homes, and real estate casinos have been negatively impacted due to the risk of assembling people and businesses during the Coronavirus pandemic.

We expect business performance to improve for many of these real estate segments should vaccinations for COVID-19 be broadly disseminated during 2021.

OUR 2021 INVESTMENT THEMES AND PORTFOLIO COMPOSITION

In 2020, we prioritized four key investment themes each of which contributed to the Fund's strong performance.

2020 investment themes

1. Opportunities in residential real estate
2. The intersection of technology and real estate and the digitalization of real estate
3. Hospitality and travel-related real estate companies
4. Tactical opportunities in REITs

2021 investment themes

In the last few months of 2020, we made tactical adjustments to the portfolio and reoriented the prioritization of the Fund's investment themes. We have chosen to incorporate a more balanced mix between traditional real estate growth companies and real estate value opportunities.

Currently, we believe a barbell approach to the Fund's investment themes and portfolio construction is prudent because COVID-19 has led to a wide disparity in share price performance and valuations for several real estate companies. We believe this valuation gap will narrow if economic activity improves in 2021.

If the extreme valuation gap between the 2020 real estate "winners" and "laggards" narrows over the course of 2021, we will likely reorient the vast majority of the Fund's holdings, once again, toward "best-in-class" real estate growth companies.

Importantly, the Fund's long-term investment philosophy remains the prioritization of "best-in-class" real estate growth companies. We do not anticipate veering from this strategy.

Regarding investment themes for 2021, we continue to believe that multi-year growth prospects for residential real estate and real estate technology companies remain compelling.

We also believe there is an exciting near-term investment opportunity for real estate companies that lagged in 2020 in large part due to temporary operational headwinds caused by COVID-19. We expect the business prospects and share prices of several real estate laggards to recover in 2021 as COVID-19 vaccinations are widely administered.

2021 investment themes

1. COVID-19 recovery beneficiaries
2. Opportunities in residential real estate
3. The intersection of technology and real estate and the digitalization of real estate

1. COVID-19 recovery beneficiaries

This investment theme encompasses what we call the "epicenter" real estate companies of the 2020 pandemic.

In 2020, certain REITs and other real estate-related businesses that rely on the assembly of people were severely impacted by COVID-19 as they were forced to shut down all or a large part of operations almost without exception. The share prices of many of these companies declined last year and remain below peak prices.

Examples of COVID-19 recovery beneficiaries include the following real estate companies:

- Hotels
- Timeshare companies
- Amusement park companies
- Casinos & gaming operators
- Cruise lines
- Real estate operating companies
- Land development companies
- Senior housing operators
- Commercial real estate services companies
- Certain REITs (i.e., office, apartment, mall, shopping center, hotel, healthcare, and gaming REITs)

Most of the real estate businesses that we are prioritizing are cyclically depressed – not secularly challenged. Consequently, we expect the cash flows of many of these real estate businesses to rebound as people are inoculated with COVID-19 vaccines and economic activity resumes.

Over the course of 2021, we anticipate the release of pent-up consumer and commercial demand for several of the hardest hit segments of real estate – particularly the travel-related segments of real estate.

Despite a recent rebound in the share prices of many of the "COVID-19 recovery beneficiaries," we believe several companies remain discounted to their likely two- to three-year prospective values.

Examples include hotel companies (**Hilton Worldwide Holdings, Inc.** and **Hyatt Hotels Corp.**), casinos & gaming operators (**Wynn Resorts Ltd.**, **Las Vegas Sands Corporation**, **Penn National Gaming, Inc.**, **Red Rock Resorts, Inc.**, and **Boyd Gaming Corporation**), vacation timeshare companies (**Marriot Vacations Worldwide Corp.** and **Hilton Grand Vacations Inc.**), amusement park operators (**Six Flags Entertainment Corporation** and **Seaworld Entertainment Inc.**), commercial real estate services companies (**CBRE Group, Inc.** and **Jones Lang LaSalle Incorporated**), real estate operating companies (**Brookfield Asset Management, Inc.**), land development companies (**The Howard Hughes Corporation**), and certain REITs (**Douglas Emmett, Inc.**, **American Assets Trust, Inc.**, **Equity Residential**, **MGM Growth Properties LLC**, and **Gaming and Leisure Properties, Inc.**).

On December 31, 2020, COVID-19 recovery beneficiary companies represented 42.8% of the Fund's net assets.

Table IV.
COVID-19 recovery beneficiaries as of December 31, 2020

	Percent of Net Assets
Casinos & gaming operators	18.3%
Certain REITs	7.6
Commercial real estate services companies	3.9
Timeshare companies	3.5
Amusement park companies	3.1
Real estate operating companies	2.9
Hotels	1.9
Land development companies	1.6
Total	42.8%

2. Opportunities in residential real estate

The strength in certain segments of residential real estate was one of the major positive economic surprises of 2020.

Both cyclical and secular tailwinds aided the U.S. housing market, and we expect these tailwinds to remain in place.

Cyclical tailwinds

Cyclically depressed levels of construction activity, low inventory levels, pent-up demand, historically low mortgage rates, and an eventual rebound in job and economic growth should continue to benefit the U.S. housing market. The current situation is nothing like what occurred during the global Financial Crisis when our country's inventory of homes was significantly oversupplied relative to demand.

Secular tailwinds

COVID-19 has also given rise to secular tailwinds that may aid the U.S. housing market for several years.

Suburban may become the new urban: A portion of U.S. families have been moving out of urban areas to more suburban towns. Given the sense of safety that comes with owning a single-family home rather than living in an apartment building (no elevators, no shared spaces, more space, less density), we expect demand for single-family homes to remain strong.

The Fund also has investments in REITs that would benefit from this movement out of urban areas into suburban areas. We expect single-family rental REIT **Invitation Homes, Inc.** to benefit as more people opt for single-family home rentals rather than apartment rentals. In the aftermath of the economic impact from the Coronavirus, we expect demand for affordable housing to benefit manufactured housing REIT **Equity Lifestyle Properties, Inc.**

Work from home or anywhere: Should work-from-home arrangements become more permanent, people will have more flexibility to relocate away from urban centers. This should lead to an increase in new home sales and single-family rentals.

More time at home may lead to more investment in the home: Homeowners are likely to spend more time at home than ever before as more employees work from home and people prioritize social distancing. This trend should contribute to homeowners spending more on home repair and remodeling activity (home office, outdoor decks and living spaces, pools, kitchens, and refreshing paint jobs). The Fund currently has investments in several companies that should benefit from this trend including: **Home Depot, Inc.**, **Lowe's Companies, Inc.**, **The Sherwin-Williams Company**, **Installed Building Products, Inc.**, **Pool Corporation**, **Fortune Brands Home & Security, Inc.**, **Trex Company, Inc.**, and **AZEK Co Inc.**

We are mindful of and will continue to monitor the potential risks to the Fund's investments in residential real estate-related companies. Many residential-related stocks performed well in 2020, certain valuations are not as compelling, year-over-year growth comparisons may be more challenging in the year ahead, and a sharp increase in mortgage rates would make homes less affordable.

Should headwinds begin to surface for the housing market, we would expect any correction in the share prices of residential real estate-related companies to be relatively shallow given the powerful cyclical and secular housing-related tailwinds.

Recently, we were struck by the notably optimistic commentary by two of the leading executives in the housing industry.

December 7, 2020: Doug Yearley, Chairman and Chief Executive Officer of Toll Brothers, Inc.

"***We are currently experiencing the strongest housing market I have seen in my 30 years at Toll Brothers***…We attribute the strength in demand to a number of factors, including historically low interest rates, an undersupply of new and resale homes, and a renewed appreciation for the home as a sanctuary. The work-from-home phenomenon is also enabling more buyers to live where they want rather than where their jobs previously required…***With our highest year-end backlog in 15 years and continued strong demand, we expect to deliver the most homes in our history in FY 2021***."

December 16, 2020: Stuart Miller, Executive Chairman of Lennar Corporation

"The confluence of Millennials starting families and creating households of their own, along with the pro-housing effects of the COVID-19 pandemic, has materially strengthened demand. This surge in demand for housing, combined with the market's inability to produce sufficient homes to meet this demand, has exacerbated the already well-documented undersupply of new and existing homes for sale…***The housing market has proven to be very strong and we expect it to continue to be a significant driver in the recovery of the overall economy over the next several years***."

We remain bullish on the prospects for homebuilders, single-family rental REITs, manufactured housing REITs, residential building products/services companies, and other residential-related real estate companies.

We remain cautious, however, about the near-term business prospects for most apartment REITs, but believe the sharp correction in apartment share prices in 2020 discounts a large portion of the expected near-term business headwinds. Recently, we have begun acquiring shares in **Equity Residential**, a leading apartment REIT, at what we believe are favorable prices. We will continue to closely monitor this company and the apartment rental real estate category. Over the long term, we remain bullish on apartment prospects primarily because they are a need-based real estate category (the population needs shelter) that should recover over time.

The Fund's ability to invest in non-REIT residential-related real estate companies such as homebuilders, land developers, building products/services companies, and home centers is one of the important differentiators that affords the Fund the ability to distinguish itself versus REIT funds.

On December 31, 2020, residential-related real estate companies represented 22.6% of the Fund's net assets.

Table V.
Residential-related real estate companies as of December 31, 2020

	Percent of Net Assets
Building Products/Services	8.4%
Homebuilders & Land Developers	7.1
Home Centers	3.7
REITs	
Manufactured Housing	1.7
Single-Family Rental	1.7
Total[1]	22.6%

[1] Total would be 27.9% if included residential-related technology companies Zillow Group, Inc., Opendoor Technologies Inc., and Redfin Corporation.

3. The intersection of technology and real estate and the digitalization of real estate

Real estate technology-related companies performed well in 2020. Although current valuations are generally less compelling than one year ago and the stocks may underperform in the near term relative to laggard real estate categories that should benefit if economic growth accelerates in 2021, we remain bullish about the long-term prospects for several real estate technology companies.

The impact of technology on real estate is undeniable. The growth in cloud computing, the internet, mobile data and cellphones, and wireless infrastructure are powerful secular drivers that should continue unabated for years and are impacting real estate, along with many other industries.

If anything, the pandemic has accelerated these secular trends as more people conduct business, leisure, residential, and commercial activities online.

Real estate-related companies that embrace and adopt the latest technological advances and innovations remain an important focus for us. Key beneficiaries of the technology revolution include data center companies, wireless tower companies, industrial REITs, real estate data analytics companies, among others.

Examples of companies we believe are poised to benefit from the impact of technology on real estate include data center companies **GDS Holdings Limited**, **NEXTDC Limited**, and **21Vianet Group, Inc.**, data center REITs **Equinix, Inc.** and **Digital Realty Trust, Inc.**, wireless tower REITs **American Tower Corp.** and **SBA Communications Corp.**, wireless tower company **Cellnex Telecom, S.A.**, and industrial logistics REITs **Prologis, Inc.** and **Rexford Industrial Realty, Inc.**

We believe the digitalization of real estate is the most exciting new development for real estate. We believe we are in the early innings of a technology-driven investment cycle centered on data and digitalization that allows real estate-related businesses to drive incremental revenue streams and lower costs. For example, we anticipate an acceleration in online activity for real estate-related transactions in the years ahead. The digitalization of residential real estate, commercial real estate, casino gambling, hotel bookings, and other segments of real estate are a key focus for the Fund. We have identified several real estate companies that are well positioned to capitalize on this burgeoning secular growth trend.

Zillow Group, Inc., for example, is the leader in online residential real estate with approximately 200 million monthly users of its leading residential real estate websites. Consumers are seeking streamlined, tech-enabled shopping experiences and Zillow is now developing a simpler real estate transaction that will enable consumers to buy, sell, rent, and finance residential real estate and save consumers time, money, and stress through technology, service, and integration. Zillow is a top holding in the Fund.

Real estate technology companies and the digitalization of real estate will remain a top priority of the Fund. We expect new real estate technology companies to enter the public market via traditional IPOs and SPACs in 2021 and the years ahead. We will continue to focus on this segment of real estate by researching these companies and building relationships with the management teams – at times, well before the companies are public.

On December 31, 2020, technology-related real estate companies represented 24.5% of the Fund's net assets.

Table VI.
Technology-related real estate companies as of December 31, 2020

	Percent of Net Assets
Data Centers	7.7%
Real Estate Data Analytics Companies	7.0
Wireless Tower Operators	1.6
REITs	
Data Center REITs	4.2
Wireless Tower REITs	4.0
Total	24.5%

Baron Real Estate Fund currently has investments in REITs, plus eight 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 VII below).

Table VII.
Fund investments in real estate-related categories as of December 31, 2020

	Percent of Net Assets
REITs	26.1%
Casinos & Gaming Operators	18.2
Real Estate Service Companies	11.0
Building Products/Services	10.6
Homebuilders & Land Developers	8.7
Hotels & Leisure	8.5
Data Centers[1]	7.7
Real Estate Operating Companies	2.9
Tower Operators	1.6
Cash and Cash Equivalents	4.7
Total	100.0%

[1] Total would be 11.9% if included data center REITs Equinix, Inc. and Digital Realty Trust, Inc.

OUR CONCLUDING THOUGHTS AND OBSERVATIONS

We have consistently stated that **no one has a crystal ball regarding the outlook** for the stock, bond, or real estate markets.

This past year, 2020, was a pointed example of the challenges of predicting the future.

The surprising breakout of a global pandemic – the Coronavirus – was an unexpected curveball that led to unprecedented health, medical, economic, and humanitarian distress. This human tragedy also triggered stock market turmoil early in 2020.

We must remain mindful that the Coronavirus pandemic persists and continues to cause uncertainty for the economic, real estate, and stock market landscape. Additional factors that could weigh on the outlook include political cross currents, interest rate concerns, and geopolitical tensions, to name just a few.

Yet, despite this lack of clarity regarding the economic and market outlook, **as we peer into 2021, we believe there are valid reasons for optimism.**

Our "big picture" view is that several key economic and market risks should recede in the year ahead:

- Many of the key concerns of 2020 – the COVID-19 pandemic, U.S. election controversies, global trade war – should diminish in 2021.
- Widespread inoculation of COVID-19 vaccines should lead to an easing of mobility restrictions, improvement in employment, and a continuation of the economic recovery.
- Corporate earnings should bounce back, fueled by the release of pent-up demand, improving profitability margins, and an increase in corporate investment activity such as mergers and acquisitions and share buybacks.
- The double barrel of exceptionally favorable monetary and fiscal support should begin to work as the global economy further reopens.
- Many companies and consumers have maintained record cash levels due to the uncertain outlook in 2020. We expect corporations and consumers to spend more cash as economic and employment prospects improve. Various companies are likely to increase capital expenditures, pursue mergers and acquisitions, repay debt, and return capital to shareholders in the form of dividends and share buybacks.
- Additional reasons to be optimistic: Inflation concerns seem well off the radar. The U.S. banking system has improved dramatically and is maintaining strong capital ratios. Substantial private capital is in pursuit of real estate and remains supported by widely available debt capital at low interest rates. Fund flows may be directed away from bonds to equities given historically low interest rates and unappealing return prospects for most fixed income alternatives.

Although there are clear differences in the prospects for various residential and commercial real estate companies, **we believe conditions are in place for much of the real estate sector to perform well in the year ahead**.

Baron Real Estate Fund Outlook

We remain optimistic about the prospects for the Baron Real Estate Fund.

We believe the benefits of the Fund's broader approach and flexibility will become even more apparent in the years ahead in part due to the new and evolving real estate landscape.

We believe the Fund is comprised of quality companies. The businesses that we continue to recommend are well managed, have market-leading positions, possess quality balance sheets, own well-located real estate, and grow cash flow at faster rates than most of their peers.

A sampling of the Fund's best-in-class companies includes:

Equinix, Inc.: The world's leading owner and operator of real estate data centers

American Tower Corp.: A leading owner, operator, and developer of communications real estate (i.e., wireless towers)

Brookfield Asset Management, Inc.: A premier global investor, operator, and asset manager of high-quality real estate and infrastructure-related assets

D.R. Horton, Inc.: The number one homebuilder by volume in the U.S., and the largest and lowest-cost producer in the entry-level home segment

CBRE Group, Inc.: The world's largest and leading commercial real estate services company

Hilton Worldwide Holdings, Inc.: One of the largest hotel companies in the world with premier hotel brands including: Hilton, Waldorf Astoria, DoubleTree, Embassy Suites, Hampton, Canopy, Conrad, and others

Alexandria Real Estate Equities, Inc.: A REIT that is the premier landlord and developer to the life science industry

Prologis, Inc.: This REIT is the world's largest owner, operator, and developer of industrial logistics real estate

The Sherwin-Williams Company: Global leader in the manufacture, development, distribution, and sale of paint, coatings, and related products

Home Depot, Inc.: The largest and leading home improvement center company in the world

We believe the Fund is structured to capitalize on compelling investment themes.

1. COVID-19 recovery beneficiaries (*hotels, timeshare operators, amusement park operators, casinos & gaming operators, cruise lines, real estate operating companies, land development companies, commercial real estate services companies, certain REITs, and senior housing operators)*
2. The ongoing recovery of the U.S. housing market with an additional boost beyond the pandemic (*homebuilders, building products/services companies, construction material companies, and home centers*)
3. The intersection of technology and real estate and the digitalization of real estate (*data centers, wireless tower operators, industrial REITs, real estate data analytics companies, and other technology-centric real estate companies*)

Valuations for several segments of real estate remain compelling. The valuations of a portion of the Fund's real estate companies–such as certain REITs, real estate service companies, homebuilders, casinos & gaming operators, and many other commercial and residential-related real estate companies–remain "on sale" at appealing prices.

Table VIII.
Top 10 holdings as of December 31, 2020

	Quarter End Market Cap (billions)	Quarter End Investment Value (millions)	Percent of Net Assets
Wynn Resorts Ltd.	$12.2	$51.1	4.9%
GDS Holdings Limited	17.5	49.4	4.7
Penn National Gaming, Inc.	13.4	40.8	3.9
Red Rock Resorts, Inc.	2.9	35.0	3.3
Boyd Gaming Corporation	4.8	34.5	3.3
American Tower Corp.	99.7	32.6	3.1
Opendoor Technologies Inc.	12.4	31.7	3.0
Equinix, Inc.	63.6	31.4	3.0
Brookfield Asset Management, Inc.	65.1	30.2	2.9
Las Vegas Sands Corporation	45.5	29.8	2.8

Final thoughts

I would like to thank our very special real estate team – David Baron, David Kirshenbaum, and George Taras – for their dedication and excellent work in 2020. In a challenging year for several segments of real estate, our team remained focused, clear minded, and energized. Well done.

We remain highly determined to diligently research, select and monitor a high-quality portfolio of companies with solid executive management, strong growth prospects, leading competitive positions, liquid balance sheets, and attractive valuations. We are enthusiastic about our investments and are optimistic about prospects for the portfolio.

I sincerely thank you, our loyal shareholders, and express my utmost gratitude for your past and continuing support during the past 11 years.

Of course, I proudly continue as a major shareholder of the Baron Real Estate Fund, alongside you.

Sincerely,

Jeffrey Kolitch
Portfolio Manager

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

Risks: In addition to general market conditions, the value of the Fund will be affected by the strength of the real estate markets. Factors that could affect the value of the Fund's holdings include the following: overbuilding and increased competition; increases in property taxes and operating expenses; declines in the value of real estate; lack of availability of equity and debt financing to refinance maturing debt; vacancies due to economic conditions and tenant bankruptcies; losses due to costs resulting from environmental contamination and its related cleanup; changes in interest rates; changes in zoning laws, casualty or condemnation losses; variations in rental income; changes in neighborhood values; and functional obsolescence and appeal of properties to tenants. 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.

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