

## DEAR BARON EMERGING MARKETS FUND SHAREHOLDER:

## PERFORMANCE

The Baron Emerging Markets Fund (the "Fund") appreciated 2.24%, while our principal benchmark index, the MSCI EM IMI Growth Index, returned 6.23% for the fourth quarter of 2012. For the full year 2012, the Fund gained 22.98%, while the principal benchmark appreciated 20.72%. During the fourth quarter, the global equity markets remained firm, driven by further signs of financial stabilization in Europe, irrefutable evidence of an economic recovery in China, as we had anticipated last quarter, and a sudden and dramatic political turn of events in Japan. In sum, we are quite encouraged by the strength of the global equity markets in the midst of the U.S. fiscal cliff and debt ceiling negotiations. Looking forward, as the market receives clarity over this remaining issue, we are optimistic regarding international and, in particular, emerging market equities in the year ahead. Although somewhat out of favor in the most recent quarter, we remain confident with our disciplined approach and focus on high quality, capital-efficient growth companies driven by strong and entrepreneurial management teams.

Table I.  
Performance (Retail Shares)

Annualized for periods ended December 31, 2012

	Baron Emerging Markets Fund <sup>1,2</sup>	MSCI EM IMI Growth Index <sup>1</sup>	MSCI EM IMI Index <sup>1</sup>
Three Months <sup>3</sup>	2.24%	6.23%	5.52%
One Year	22.98%	20.72%	18.68%
Since Inception (December 31, 2010)	0.91%	-1.75%	-2.25%

While we were pleased overall with our performance for the year, which exceeded our benchmark, we were disappointed with our fourth quarter performance. The relatively weak fourth quarter was attributable to a number of unusual company-specific factors as well as a general shift in investor sentiment towards more cyclical and financially leveraged stocks that had

Performance listed in the above table is net of annual operating expenses. As of the last fiscal year ended December 31, 2011, the annual operating expense ratio for the Retail Shares was 4.49% but the net annual expense ratio was 1.50% (net of the Adviser's fee waivers). *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 has reimbursed certain Fund expenses (by contract as long as BAMCO, Inc. is the adviser to the Fund) 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](http://www.BaronFunds.com) or call 1-800-99BARON.*

<sup>1</sup> The MSCI EM (Emerging Markets) IMI indexes cited are unmanaged, free float-adjusted market capitalization weighted indexes reflected in U.S. dollars. The MSCI EM (Emerging Markets) IMI Growth Index Net USD and the MSCI EM (Emerging Markets) IMI Index Net USD are designed to measure equity market performance of large-, mid- and small cap securities in the emerging markets. The MSCI EM (Emerging Markets) IMI Growth Index Net USD screens for growth-style securities. The indexes and Baron Emerging Markets Fund include reinvestment of dividends, net of foreign withholding taxes, which positively impact the performance results.

<sup>2</sup> The performance data does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or redemption of Fund shares.

<sup>3</sup> Not annualized.



MICHAEL KASS  
PORTFOLIO MANAGER

Retail Shares: BEXFX  
Institutional Shares: BEXIX

largely underperformed previously in the year. For the full year, strong stock selection in the Consumer Discretionary and Telecommunication Services sectors drove our outperformance. Notably strong contributors in these sectors were our Indian digital media investments, **Hathway Cable & Datacom Ltd.**, **DEN Networks Ltd.**, **Zee Entertainment Enterprises Ltd.** and **Dish TV India Ltd.**, our Brazilian post-secondary education holdings, **Anhanguera Educacional Participações SA**, **Kroton Educacional SA** and **Estácio Participações SA**, and our Indonesian wireless communications tower investments, **Tower Bersama Infrastructure Tbk PT** and **Sarana Menara Nusantara Tbk PT**. Our largest single contributor to performance for the year was **Tower Bersama Infrastructure Tbk PT**. Poor stock selection in the Information Technology and Financial sectors was a significant detractor from relative performance for the year. Within Information Technology, operational disappointments at companies such as **Ubiquiti Networks, Inc.**, **Net 1 UEPS Technologies, Inc.**, **Daum Communications Corp.** and **Kingdee International Software Group Co. Ltd.** dragged down performance. The largest individual detractor for the year was **NII Holdings, Inc.**, a Latin American wireless communications provider, whose inability to launch its enhanced 3G network on time led to market share and ARPU declines.

Table II.  
Top contributors to performance for the quarter ended December 31, 2012

	Percent Impact
Tower Bersama Infrastructure Tbk PT	0.70%
Kroton Educacional SA	0.49
Universal Robina Corp.	0.44
Exillon Energy plc	0.42
Hathway Cable & Datacom Ltd.	0.37

**Tower Bersama Infrastructure Tbk PT** is the second largest independent owner of wireless towers in Indonesia. Tower Bersama's share price rose during the fourth quarter after announcing impressive quarterly results. Data traffic is growing at high rates in Indonesia, and operators are investing in network assets to



# Baron Emerging Markets Fund

accommodate it. As a result, Tower Bersama is generating increased leasing revenue and cash flow from colocation activity. Tower Bersama's Indosat tower acquisition closed during the quarter.

**Kroton Educacional SA** is one of the largest for-profit, post-secondary education providers in Brazil. Its shares have returned 32.0% in the fourth quarter as it posted phenomenal results on the back of the Financiamento Estudantil (FIES), a revamped student loan program provided by the Brazilian government. While the FIES should benefit the industry as a whole, we think it should benefit Kroton even more given Kroton's substantial exposure to students with this loan.

Companies with large exposure to soft commodities, such as corn, wheat, sugar, or cotton, typically perform better when input costs are declining as they did in 2012. **Universal Robina Corp.**, the largest branded food company in the Philippines, is an example of such a company. In the back half of 2012, Universal Robina's domestic consumer division grew at a rate in the high teens, while improving group operating margins by over 250 basis points.

Shares of **Hathway Cable and Datacom Ltd.** rose 22.6% in the fourth quarter. The company is one of India's largest cable TV and broadband providers, and is currently benefiting from digitization of cable systems as mandated by India's government. The outperformance during the quarter is largely attributable to the timely execution of this process.

**Table III.**  
Top detractors from performance for the quarter ended December 31, 2012

	Percent Impact
Net 1 UEPS Technologies, Inc.	-0.88%
Africa Oil Corp.	-0.46
Shandong Weigao Group Medical Polymer Co. Ltd.	-0.40
21Vianet Group, Inc.	-0.35
Daum Communications Corp.	-0.32

**Net 1 UEPS Technologies, Inc.** (UEPS) offers a smart card-based system, which facilitates electronic payments and transactions for underserved emerging market populations. UEPS was recently awarded a long-term contract to administer benefits for the South African Social Security Administration (SASSA). In early December, UEPS disclosed an SEC investigation into possible improper payments made to secure the SASSA contract. Given this development, we sold our position.

**Africa Oil Corp.** is an oil exploration company with a substantial land position in East Africa. The stock has been one of the strongest performing E&P stocks in 2012 due to the success of its initial well in Kenya, which appears to be a large basin-opening discovery. Despite its success, the shares sold off in the fourth quarter as the results of the second well did not meet elevated investor expectations. Africa Oil has no current production or cash flow, which increases the risk of the stock, but it has a first mover strategic position in a potentially important new hydrocarbon basin.

Shares of **Shandong Weigao Group Medical Polymer Co. Ltd.** fell 22.1% in the fourth quarter. The company develops, manufactures, and sells consumable medical products primarily in China. Underperformance during the quarter was due to near-to-midterm concerns relating to its distribution network and termination of its joint venture with Medtronic. As a result, management lowered earnings guidance for fiscal 2012. We retain conviction in the long-term fundamentals of the business due to the high growth opportunity within China's health care industry.

**21Vianet Group, Inc.** provides carrier-neutral Internet data center services in China. Its services include hosting and related services, managed network services, and cloud infrastructure services. 21Vianet underperformed as the company invested ahead of traffic growth, which led to margin deterioration. We continue to believe in the company's growth opportunity, and Microsoft's choice of 21Vianet as its Chinese partner reaffirms our belief in management's ability to drive strategic growth initiatives.

**Daum Communications Corp.** is the second largest Internet portal in South Korea. The fourth quarter of this year was an especially challenging quarter. Investor sentiment sharply reversed as Daum made an unpopular decision to insource its advertising agent. While we think this is potentially a sound, long-term strategic decision, insourcing raises uncertainties, including whether the company can preserve its customer base, maintain or benefit from pricing, and avoid heavy investments often required in such a transition.

## PORTFOLIO STRUCTURE

**Table IV.**  
Top 10 holdings as of December 31, 2012

	Percent of Net Assets
Tower Bersama Infrastructure Tbk PT	2.9%
Kroton Educacional SA	2.8
Sarana Menara Nusantara Tbk PT	2.7
Financial Technologies Ltd.	2.6
Zee Entertainment Enterprises Ltd.	2.5
DEN Networks Ltd.	2.4
M. Dias Branco SA	2.1
Qualicorp SA	2.1
Anhanguera Educacional Participações SA	2.1
KT Skylife Co. Ltd.	2.0

## EXPOSURE BY COUNTRY

**Table V.**  
Percentage of securities by country as of December 31, 2012

	Percent of Net Assets
Brazil	19.0%
India	18.7
China	13.0
Indonesia	11.6
Philippines	6.0
Korea	4.2
Thailand	3.3
Russia	3.1
Taiwan	3.1
Chile	3.1
Mexico	2.9
Hong Kong	1.9
South Africa	1.7
Canada	0.9
Norway	0.7
United Arab Emirates	0.6

**Exposure by Market Cap:** The Fund may invest in companies of any market capitalization, though we have generally focused on mid and smaller cap companies, as we believe such companies often have more attractive growth potential. At the end of the fourth quarter of 2012, the Fund's

median market cap was \$2.0 billion, and we were invested approximately 11.7% in large cap companies, 34.3% in mid cap companies and 47.8% in small cap companies as defined by MSCI.

## RECENT ACTIVITY

Given our outlook, during the fourth quarter we focused our idea generation on the margin on companies we see as beneficiaries of the changing economic environment in China, as well as the shifting monetary stance in Japan, consistent with our investment discipline. We took advantage of poor short-term investor sentiment towards advertising driven businesses in China by initiating a position in **Sina Corporation (SINA)**. SINA is one of China's leading online platforms best identified as operating the highly popular Sina Weibo, a "Twitter-like" microblogging service with an estimated 400 million users. We believe Sina Weibo represents significant strategic value, far undervalued at the current stock price, and we believe recent speculation, if accurate, of a potential investment by Baidu, Inc. or Alibaba Group would serve to highlight such value. Additional new positions include **Ginko International Co. Ltd.**, a leading branded contact lens and solution manufacturer and marketer in China and Taiwan. We believe the Ginko's growth opportunity and competitive position are quite attractive, particularly in the faster growing Tier 2 and Tier 3 cities of China, where we expect a long-term transition towards higher-frequency lenses to drive operating margin expansion. We also initiated a position in **KT Skylife Co. Ltd.**, a leading digital satellite-based, pay television operator in Korea, with we think an attractive growth opportunity, particularly given its partnership with its corporate parent, Korea Telecom. We also believe the company can materially expand operating margins by leveraging its broad distribution to capture a growing share of home shopping revenues. In addition, we established initial positions in **MediaTek Inc.**, a leading provider of communications software and chipsets well positioned in our view for the coming explosion in smartphones in China and the emerging markets, and **Lippo Karawaci Tbk PT**, Indonesia's leading residential, commercial and retail property developer and also its leading operator of health care facilities. During the quarter, we exited positions where events caused us to lose investment conviction, including **Itaú Unibanco Holding SA**, **Net 1 UEPS Technologies, Inc.**, and **Formosa International Hotels Corp.**

## OUTLOOK

Last quarter, we outlined how the elimination of near-term concerns over a European sovereign default helped drive an impressive third quarter rally in equities, and suggested that accelerating signs of an economic recovery in China would benefit international markets, particularly the emerging markets. During the fourth quarter, we witnessed additional signs of European financial stabilization, with sovereign bond spreads, in particular,

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narrowing to recent lows and irrefutable evidence of a recovery in China. While we have lingering concerns over long-term political compromise on European fiscal union, as well as the longer-term growth outlook for China, we remain confident and enthusiastic regarding the prospects for international and emerging market equities as we enter 2013.

Another reason global economic prospects are brightening in the new year is the impact of a new round of aggressive monetary support from central bankers. While many investors are familiar with Ben Bernanke's move to open-ended quantitative easing and unemployment rate targeting, a more significant recent catalyst is Japan, where a sudden and resounding change in political leadership in favor of Shinzo Abe and the LDP party was based on a pro-growth platform targeting higher inflation and aggressive monetary easing. We believe the recent rejuvenation of monetary easing campaigns, juxtaposed with negligible yields on higher quality government bonds, is finally driving capital into higher yielding, riskier assets, including equities and emerging market bonds. In our view, this trend is likely to become increasingly evident during the coming year.

Shifting to our investments, we remain steadfast in our commitment to leading entrepreneurial companies with what we believe are visible, long-term growth prospects and sustainable competitive advantages that generate more attractive returns on capital. During the past year, we had considerable success with our principal investment themes, which we believe continue to offer great promise over a long-term horizon. To review, we favor high quality companies positioned to serve the expanding middle class consumer in the developing world; to broaden credit availability and/or increase the sophistication of capital markets activities in such countries; to drive manufacturing and/or business process productivity to offset rising wage pressures; or to enable agricultural yield or energy efficiency on a capital efficient basis. We are enthusiastic over the potential of the investments we hold in the Fund.

**Thank you for investing in the Baron Emerging Markets Fund.**

Sincerely,

Michael Kass  
Portfolio Manager  
January 8, 2013

For more information about this Fund please scan this QR code with any bar code reader on your mobile device.

